Telefónica January-March 2018
Results Conference Call Transcript

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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 related to APM used in this presentation are included in the consolidated financial statements and consolidated management report for the year 2017 submitted to the Spanish National Securities Market Commission (CNMV), in Note 2, page 283 of the .pdf filed. Recipients of this document are invited to read it.

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Introduction

Pablo Eguirón – *Global Director of Investor Relations*

Good morning, and welcome to Telefónica's conference call to discuss January-March 2018 results. I am Pablo Eguirón, Global Director of Investor Relations.

Before proceeding, let me mention that financial information contained in this document related to the first quarter 2018 has been prepared under international financial reporting standards, as adopted by the European Union. From the first of January 2018 we have implemented IFRS 15 & 9, and all financial information in this presentation is based on this new standard. In organic terms, the effects of the accounting change to IFRS 15 are excluded in 2018. 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 or London. Now let me turn the call over to our Chief Operating Officer, Mr. Ángel Vilá.

Presentation

Ángel Vilá – *Chief Operating Officer*

Highlights | Execution of strategic priorities

Thank you Pablo. Good morning and welcome to Telefónica’s first quarter results conference call. With me today is Laura Abasolo, Chief Financial and Control Officer. Following our presentation, we will host a Q&A session and invite you to ask any questions you may have.

I’d like to start this call by sharing with you an update on the execution of our strategic priorities:

- First, our total access base reached 357 million, highlighting strong growth posted by LTE, smartphones, Fixed UBB and Pay TV. In addition, we have increased our own fibre footprint by 15% y-o-y to a total of 45.8 million premises passed with Fibre and Cable, and advanced further in our focus on monetization.
- Second, all of our business units delivered revenue and OIBDA growth, excluding the impact of regulation.
- Third, we continued to strengthen our differential platforms and advanced in our digitalisation and monetisation journey. As such, we launched Aura in 6 countries, leveraging on cognitive intelligence to enhance customer relationship.
- Overall, this translated into incremental revenue, OIBDA and OpCF growth, at a group level, with further net debt reduction. In addition, Q1 results are in line with our expectations, allowing us to reiterate guidance for the full year.

Key financials Q1 18

To review Telefónica's key financials, please turn to slide number 3.

Reported figures for the first quarter reflected the new IFRS 15 & 9 accounting standards, with a limited impact on both revenues and OIBDA. However, 2017 figures are reported under IAS 18. As such, year-on-year reported variations are affected by accounting changes, by the negative evolution of FX, regulation, restructuring costs and tower sales.

On an organic basis, growth is robust and accelerated from revenues to OpCF, as top line grew +1.9%, OIBDA 3.3% and OpCF 4.4%.

Net income surpassed 830 million euros, 7.4% more than in January-March 2017 and underlying Earnings per share reached 0.17 euros.

FCF of 550 million euros is a positive result in a quarter traditionally negatively impacted by seasonality and is growing pre-dividends to minorities.

Guidance confirmed

Moving to slide 4,

Based on Q1 results, which were in-line with our expectations, we confirm our 2018 guidance, as seen in the table to the top left of the slide. We are well on track to meet our guidance and are executing actions to maintain a solid balance sheet, to pursue additional deleveraging, improve ROCE and offer an attractive, stable and sustainable shareholder remuneration.

We also confirm the dividends to be paid in the calendar year: 0.2 euros per share on 15th of June, which is the second tranche from the 2017 dividend, and 0.2 euros per share on 20th of December, which will be the first tranche for the 2018 dividend. The second tranche of the 2018 dividend, 0.2 euros per share, will be paid in June 2019.

Sustained free cash flow generation

On slide 5, free cash flow generation reached 550 million euros, roughly 50 million euros less than in January-March 2017. As shown in the graph on the top right of the slide, FCF evolution is affected by a one-off payment to Telxius minorities. Before minorities, FCF grows by 15.2% to a total of 719 million euros.

This strong cash generation has helped to reduce net financial debt in the first quarter by 255 million euros. This is the best first quarter performance on the last 4 years. In addition, net debt declined 4.8bn euros in the last 12 months, a 10% decline.

Let me remind you that Q1 is traditionally impacted by negative seasonality. For the rest of the year, we expect FCF to substantially improve.

FX impact structurally neutralised

Moving to slide 6, we will share with you some more details with regards to FX impact.

The largest impact that is affecting the y-o-y evolution of our revenues and OIBDA in the first quarter is the EUR appreciation. This is a factor affecting many European companies.

FX dragged OIBDA by 372 million euros in the first quarter, but impact in FCF was reduced to just 26 million euros, as FX also reduced payments in euros of CapEx, taxes, financials and minorities.

The use of spot rates for the calculation of Net Debt versus average rates for the P&L mainly explains the net debt increase in the first quarter. In the 12 month rolling period to March 2018, FX reduced net debt by 722 million euros.

Positive delivery in Revenues, OIBDA & OpCF

As you can see on slide 7, we are delivering positive organic growth across key financials. In reported terms, the y-o-y decline diminished as we move from Revenues down to OpCF, which was pretty stable.

OIBDA margin expanded 0.4 percentage points in organic terms in the quarter to 31.7% benefitting from the increasing relevance of digitalisation, cost efficiencies and synergies.

OpEx was stable in reported terms and we continued to be more efficient in CapEx, with a 1.5% year-on-year increase due to different phasing vs. previous year. This increase will revert in the following quarters, as we are covering more with less investments.

And finally, OpCF margin expanded 0.5 p.p. in organic terms.

Monetisation focus enhanced

Now, let me present the progress made on data monetisation.

The opportunity is huge given the exponential growth in data traffic. Therefore, we are enhancing our focus on the three levers we employ: attracting, bundling and up-selling.

Each quarter we attract more high-value customers, as reflected in the increased LTE and fibre penetration. Once they are a Telefónica customer, we then bundle voice and data in various ways with tailored and innovative offerings to foster upselling. We add exclusive video content to our tariffs, enlarge data allowances or make the prepaid data plans recurrent.

The results are positive. Bundling encourages usage and increases our customer loyalty, while upselling increases ARPU by double digits when customers move, for example, from copper to fibre or from 3G to 4G.

We are a platform Co. to better serve customer needs

On slide 9 we lay out our platform strategy and why we believe this structure best serves our customers' needs.

In the first platform, our physical assets are supporting connectivity, and we continue to build leading-edge networks for tomorrow. LTE coverage reached 92% in Europe and 66% in Latam, and UBB coverage is now at 76m premises passed. Additionally, we are moving towards 100% virtualisation of the network.

In the same vein, we are accelerating end-to-end digitalisation in the second platform to advance in Real Time process automation, with the largest Full Stack transformation in the industry. Our E2ED index is up 9 percentage points year-on-year to 61%.

The evolution of our third platform, products and services, has allowed us to offer a distinctive value proposition. Broadband Connectivity and Services Beyond Connectivity now represent 53% of total Revenues.

Finally, in the fourth platform we are pioneering Artificial Intelligence to make the new customer relationship model a reality, with 1.3 petabytes of data being processed a month. We have launched Aura in 6 countries, as shown on the following slide.

Aura, the new customer relationship model

Leading the integration of AI in networks & customer care

On slide 10 we present Aura, a new way of experiencing and interacting with Telefónica based on our 4th Platform capabilities.

It's a one-stop shop for our customers' needs, delivered via own and third-party apps which allows customer to talk to technology in real time to get things done.

This will build a relationship of trust with our customers based on data transparency and security and will have a positive impact in terms of customer acquisition and retention plus improved brand perception.

We have already launched Aura in 6 countries, and further innovations will come during 2018, such as the Movistar Home device, to be launched in Spain.

Digitalisation, a leap forward in our bold transformation

Enhancing Customer Experience and Operational Efficiency

On slide 11,

We are taking a step forward in our digitalisation programme, an area in which we are pioneers. We have a clear objective here: to imbue digitalisation in everything we do.

As such, across our geographies we are focused on the execution of the initiatives set around 5 priorities to improve the customer journey: to foster sales through own digital channels, to expedite payments and collections, to improve provision and technical support and to enhance customer care experience.

As a result, we are increasing customer engagement and progressing well towards our goal of more than 300 million euros savings this year.

Now, I will hand over to Laura.

Laura Abasolo – *Chief Financial and Control Officer*

Spain | Solid trading in a rational market

Moving to slide 12, we present the performance of the domestic business.

In a market led by “M4M” strategies, our increasingly competitive offering drove a solid commercial trading in value services, with a noteworthy churn reduction seen across the board.

“Fusión” continued to post healthy growth in customer base and total accesses. “Fusión” ARPU increased 7.5% year-on-year, on the back of tariff upgrades and an improved value mix thanks to the enhanced portfolio.

The leading quality and scale of T. España’s networks are unrivalled and they continue to deliver growth in both the retail and wholesale business, as proven by the recent wholesale fibre agreements signed with key players in the market.

Spain | Improving revenue and OIBDA trend

Moving on to slide 13, we present how the growth profile of T. España is also reflected in its financials.

Service revenues accelerated their year-on-year growth to 0.8% in the quarter, on the back of a better performance from retail revenues and despite declining wholesale revenues, which were impacted by the gradual loss of wholesale accesses from MásMóvil and MTR cuts. Excluding these impacts, Service Revenues would have increased 1.8% year-on-year.

As a result of this positive top-line trend, in combination with cost discipline and lower commercial costs, OIBDA posted a 0.6% year-on-year growth and margin stood at 39.5%, flattish year-on-year.

Finally, OpCF margin stands out among European peers at 28.3% despite a slight increase in CapEx due to different phasing vs last year.

Germany | Positive financial performance

Telefónica Deutschland, on slide 14, demonstrated the continuous market momentum in a dynamic yet rational competitive environment. In the first quarter, the Company successfully continued its integration process and was ranked number 2 in the Connect Mobile Hotline-Test.

The first quarter presented strong KPIs performance, supported by solid contract net adds of 157 thousand customers and robust partner trading. LTE accesses increased 15% y-o-y to 16.1m. Additionally, data traffic continued its strong growth and was up 46% y-o-y, supported by the new O2 Free tariff portfolio.

On financials, MSR ex-regulation continued its improving growth path, while handset sales registered a y-o-y increase of +10.5%. OIBDA posted a sustained growth of 0.7% y-o-y and further margin improvement of 0.3 p.p. y-o-y, with a successful synergy capture of €35m which more than offset the ongoing regulatory drag.

Finally, it is worth highlighting the OpCF increase of 7.1% vs. Q1 17, also boosted by CapEx synergies of ~€15m and efficient CapEx spend on network consolidation & LTE rollout.

UK | Solid financials, capability enhanced

Turning to slide 15,

The UK delivered another robust financial performance this quarter. We are highly satisfied with the results of the recent spectrum auction, in which we won the largest share of spectrum for the lowest price per MHz. The 40 MHz of 4G spectrum we have won enables us to enhance connectivity for our customers right away, while the 40 MHz of 3.4 GHz spectrum will be suitable for the development of 5G technologies.

Telefónica UK's award-winning network remains the largest in the country with 32m customers, leveraged on sustained growth in higher value customers and market-leading loyalty levels.

This high-quality base has led to another strong quarter of organic MSR growth of 2.8% excluding regulation, leading to total revenue growth of 2.9%, as consumers and businesses alike continue to choose us to be their preferred network provider.

OIBDA was up 6.1% in the quarter, despite the continuing regulatory drag, mainly from RLAH, while benefitting from lower Annual Licence Fee payments. As a result of this and the phasing of CapEx investments, OpCF was up 32.9% year-on-year.

Brazil | Growth and value

Moving on to slide 16 on Brazil.

- Our unique assets once again allowed us to post a strong set of results:
- Post-paid Q1 net adds increased by an outstanding 67% y-o-y with a stable churn rate of 1.6%
- New fibre connections accelerated to 102k in the quarter, with an impressive take-up ratio of 50% in the first 5 cities launched in 2017
- In Pay TV, we continue to focus on IPTV, which has a higher internal rate of return, uses cutting-edge technology, and currently represents 27% of our total TV accesses

This quality growth enabled us to maintain an outstanding ARPU growth across our main services.

Brazil | Delivering profitable growth

On to slide 17 we show the consistent and solid financial performance in Brazil.

- Mobile service revenues increased 3.5% y-o-y, once more well above inflation, driven by mobile data and tariff updates.

- The fixed business trend continued to be affected by the decline in voice, fixed to mobile substitution and DTH. These negative effects were partly offset by the outstanding growth of almost 22% in fibre and 67% in IPTV.

Finally, OIBDA margin increased to 36.3%, the highest margin since 2009, underpinned by our ongoing cost reduction efforts built on efficiencies, digitalisation and simplification measures.

South Hispam | Healthy and consistent growth

Moving to slide 18.

In South Hispam, mobile contract quarterly net adds reached 159 thousand, well above last year levels, with Peru posting positive figure for the first time in 7 quarters and Chile strengthening the upwards trends shown since the second half 2017.

At the same time, Fibre connections posted a 4-fold increase and Pay TV accesses were up 7% year-on-year while penetration levels still remain low.

This focus on quality, along with a better macroeconomic backdrop, resulted in healthy financial results with revenue growth of 7.6%, OIBDA of 10.8% and margin expansion of 0.8 percentage points.

North Hispam | Commercial success overshadowed by regulation

Turning to North Hispam on slide 19, it is worth highlighting our commercial success, delivering best-in-class connectivity through continuous network improvement:

In mobile, we reached the highest ever contract net adds in the region, while penetration of smartphones and LTE is ramping-up.

In the fixed business Fibre adoption accelerated after adding 41k new fibre connections in the quarter.

However, revenues and OIBDA were negatively impacted by the new regulation in Mexico implemented at the start of 2018. Excluding this adverse impact, revenues and OIBDA grew.

Telxius | New "MAREA" cable now in service

On slide 20 we show the Telxius highlights. The key development to flag is that MAREA cable came into service at the end of March and is now connecting US and Spain.

The tower portfolio continued to grow 3% year-on-year, as 24 new towers were added mainly in Spain and Brazil, amounting to more than 16 thousand in total, while tenancy ratio also grew to 1.34x.

Solid financials were maintained in the first quarter, with improving revenue trends (+2.0% up year-on-year) mainly driven by tower business. OIBDA margin levels were sustained at 47.6%.

CapEx reflected the efforts deployments of the two cables MAREA and BRUSA. We expect to reduce the CapEx levels during the second half of the year, when BRUSA comes into service.

Net debt reduction despite seasonal Q1 effects

Let’s move now to the financial metrics on slide 21.

Net debt has reduced below the 44bn euros mark mainly thanks to healthy FCF generation. Net Debt/OIBDA ratio remains range bound at 2.67x despite the usual Q1 seasonality.

Our hybrid liability management exercise had a temporary positive effect on debt reduction in Q1 that will reverse in Q3, when the remaining amount on hybrid with non-call September 2018 is called. Overall, the hybrid management exercise has had a positive mid-to-long term impact.

Focused on attractive long-term financing

Slide 22 shows how Telefonica keeps on actively approaching the market with over 10 billion euros long-term financing completed in Q1. As a result, we have increased our average debt life in excess of 9 years and maintained our liquidity cushion over 20 billion euros. Therefore, facing comfortably next two years of maturities.

The interest payments effective cost in the last twelve months stood at 3.50% as of March 2018, stable compared to a year ago. The positive evolution in Latin America is compensated in Europe due to different coupon payment calendar.

I will now hand back to Ángel.

Ángel Vilá – *Chief Operating Officer*

Q1 Summary/ Delivering robust financials

Thank you Laura. To summarise:

First, we are making excellent progress with regards to our strategic priorities, focused on our mission to "Let our customers choose it all".

Second, we had a healthy start to the year, delivering robust financials.

And third, we are reiterating our 2018 guidance.

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

Q&A session

Joshua Mills – *Goldman Sachs*

The first question is quite a straightforward data point. On Slide 11, you've laid out quite a few targets for digitalisation. I wondered if you could give us statistics that some other operators have as to how many of your sales, maybe just in Spain, are actually done online now and how that has changed over the past year or so. I think a few operators said it is around 20% already.

The second is actually a bigger-picture question on your convergent strategy in Europe. So the message has always been that whilst you are convergent in Spain, you are less worried about having fixed line in Germany and the U.K., which you haven't had the same level of fibre built in. Now that level of fibre build may be increasing. You potentially have some strategic options to go for cable wholesale in Germany, if Vodafone unity gets approved, or maybe buying assets in the U.K. So my question is: do you think there is a bigger need now for convergence in either of those markets than there was before? And why is it that you think your U.K. mobile-only trends seem to be holding a lot better than your German mobile-only trends when you look at net adds, ARPU, etc., on an underlying basis?

Ángel Vilá – *Chief Operating Officer*

On digitalisation, we have described in Page 11 the five areas in which we are focusing with regards to the customer journey. These are the targets for 2020. We had already put this in the previous presentation in the last quarter. And we are including examples of how in different geographies, we are progressing in different points. So for instance, in direct customer interaction regarding to sales, we expect across the group to increase over the next three years by 2.5x the sales in self-assisted channels. Offer personalization is increasing conversion rate in online channels, and it also increases value sales. So in this sense, Spain is already showing progress. At the end of 2017, Spain has already achieved 40% of sales personalized, so this is a good KPI with respect to the Spanish operation compared to some peers.

Regarding convergence strategy in Europe, and in particular with respect to the markets in U.K. and Germany, we have always stated, and we continue to be of the same opinion, that convergence is supply-driven. Convergence is depending on the specificities of each one of the markets. But what we're seeing both in Germany and in the U.K. is soft convergence trends, with a relatively limited traction so far.

We have different hedges to our mobile-centric exposure, both in the U.K. and Germany. In Germany, we have a long-term agreement to access the ultra-broadband network of Deutsche Telekom. And in the U.K., on the one hand, one of the leading players that is aiming for convergence, which is Sky, has an MVNO on us, so we have partial hedge. And, in addition, regulatory measures regarding Openreach are going to be providing progressively access to that network and other independent players are building fibre networks. We keep on monitoring those developments to have access to backhaul or more capillar fibre when needed, but we believe that our mobile-centric approach in both markets is sustainable.

And I think that you finally were commenting on the different performance of the mobile operations in Germany and U.K. These are different situations.

In the U.K., we deliver very solid results. We remain being the leading mobile network carrier with a base in excess of 32 million. We are growing 0.4% year-on-year. The post-paid base grew 1.2%, the LTE grew 2.7% reaching a penetration of 60%. There was increased customer spend in the U.K., and we continue to have the leading level of customer loyalty with churn below 1%, and this has flown into financials in our U.K. operation.

In Germany, we continue to have progressively better commercial momentum in B2C and in B2B. And we are in a trend that, if you exclude regulation, we are moving towards better mobile service revenue trends. Different markets, but in both, we are the leader in terms of number of subscribers in mobile, and in both, we are improving and, in the case of the U.K., posting a shining performance.

Joshua Mills – *Goldman Sachs*

Just one very quick follow-up. Would you consider co-investing with some of these smaller fibre players, either in the U.K. or Germany, to get better fixed line access terms, as CityFibre or Deutsche Glasfaser, for example?

Ángel Vilá – *Chief Operating Officer*

We're open to agreements with players in order to have the infrastructure that we may need for our operations. So yes, we're absolutely open to explore such agreements if they were needed by our operations to deliver to their customers.

Mathieu Robilliard – *Barclays*

The first one on fibre rollout in Spain. So the regulator has now released what the wholesale prices will be for fibre, and I wanted to get your take on how you view these prices. And more importantly, how does that affect your plans in terms of FTTH roll out in Spain? I think this was something you were waiting to have confirmation on to have a better sense of what kind of profitability you could reach from these investments.

And the second question, with regards to the U.K., so very good results on the spectrum auction. I was wondering how fast can be put this spectrum at work, and how does that impact your thinking in terms of any potential IPO for this asset?

Ángel Vilá – *Chief Operating Officer*

With respect to the regulation of fibre in Spain, the NEBA fibre wholesale price which applies to regulated areas is based on replicability. Formerly, it was cost based, now it's based on replicability. This means that every retail offer from Telefónica must be replicable with profitability by competitors.

The new price of NEBA service has been set at EUR 17.57, which is clearly better than the initial consultation price and recognizes a significant price premium versus copper.

This price allows Telefónica to combine the generation of wholesale revenues, but at the same time allows for a competitive retail offer. And the price will be periodically reviewed every 6 months. Any "More for More" strategy will be reflected in NEBA price variations or increases even.

So this is allowing for a simultaneous generation of wholesale revenues, as we have entered into wholesale agreements with Vodafone and Orange, which are being reflected in the nice take-up of the fibre wholesale accesses, the NEBA fibre accesses have multiplied by 2.3 year-on-year. But at the same time, we're going to have competitive retail offer. This will also result in avoiding an overbuild of fibre in the country.

With respect to the U.K. spectrum, Telefónica U.K. acquired the most amount of spectrum in the auction at the lowest price per megahertz (MHz). This was an auction in which the industry has displayed rationality. And the more balanced spectrum distribution will benefit U.K. mobile customers. The spectrum is already in use. The first sites (because we had been preparing thoroughly for this), the first sites went live within 6 minutes of spectrum award and 60 sites went live within 4 hours. And another 100 sites will be already live by the end of April. So this spectrum is already at work and is giving our customers an immediate boost in the user experience. So with this successful auction behind us and the very nice performance of our U.K. operation, we continue to progress on the preparation of a potential IPO.

For us, the U.K. market is strategic, because it's at the forefront of the digital customer revolution in Europe. The U.K. operation is displaying a very good performance. This successful outcome of the spectrum auction is giving us the capability to strengthen our quality proposition. We are a stronger company now than we were when we last spoke in the previous conference call. And imagine, if our performance was good so far, from now on, without capacity restrictions, how it can be. So the IPO is still an option, we keep working on it. We will be monitoring market conditions. We will be prepared as soon as there is, if there is, a suitable window of opportunity.

Ivón Leal – *BBVA*

Just maybe one question on football and trying to understand how you're approaching the next auction on football. The first thing is, I think you're going to have to negotiate the Champions League rights before the La Liga rights. So I'd like to understand if you feel you can make different offers for Champions League or La Liga. Or forcedly, do you think that has to go in the same package? The second one is: do you think the availability of an OTT offer has hurt your return on football rights, and therefore, for the next seasons, you need to secure both OTT package and the normal package? Those are the 2 questions on football.

Ángel Vilá – Chief Operating Officer

Well, first, the Champions League and La Liga are separate and different processes. Not only they are different processes, but also the periods, the seasons, for both contents are different. For the Champions League, there is a cycle that starts for 3 years starting this coming September, so '18/'19, '19/'20, '20/'21. La Liga would be one year after, the cycle that starts in September '19, so '19/'20, '20/'21 and '21/'22. So, they're 1 year separated.

As you know, in the last results call, we affirmed that regarding soccer rights, both Liga and Champions, we would always be analysing the cost/benefit equation in a rational way. And we also stated that there was a distinct possibility that we may not renew the Champions League contract. One quarter on, both statements remain absolutely valid.

During this period, Mediapro started the process to market the Champions League for the next 3 seasons. This is an attractive content for our customers, provided that it is acquired at economically sound conditions. The Mediapro process includes a condition of confidentiality, so that we cannot give specific details. But what I can tell you is that you should expect us to proceed according to very strict cost/benefit rationality and acknowledging that there is a very distinct possibility that we may not acquire such content.

Then with respect to La Liga, the conditions or even the calendar of the auction of La Liga is not clear. It's still in a process of consultation between La Liga themselves and the antitrust regulator, so the conditions are not clear. Here, the key issue is whether To Bid or Not To Bid, that is the question. And we will respond to this question based on what conditions and minimum prices, and the possibility of different lots and the possibility of variable prices. But always, with a rational cost-benefit analysis.

And you were asking about the over-the-top offer on those rights. The conditions of the auction of La Liga are not clear, but I would think it would be unwise for La Liga to set conditions that would shut off their main distributors. I hope this answers your question.

David Wright – *Bank of America Merrill Lynch*

I think, historically, you guys have talked about the potential for some asset divestment or portfolio restructuring in Latin America. And there was a clear move obviously to recategorise the north and southern regions which I think it's quite clear some significant underperformance coming from the north. Mexico in particular, and Venezuela looks literally like it's trending down towards 0. Could you talk a little bit about your ambitions for those assets? And how you can stem some of the declining return on capital profiles there, please?

Ángel Vilá – *Chief Operating Officer*

We constantly monitor our portfolio of assets according to profitability, return on capital employed criteria and derive better strategic positioning for our portfolio from those.

When we restructured Hispanoamérica along the regions, we wanted to recognize 2 different realities. In Hispanoamérica South, we are mostly former incumbents with fixed and mobile capabilities, strong market positions, which have a very different approach to what we have in Hispam North, which are mostly mobile-centric attackers (with the exception of Colombia where we have more capabilities). In both regions, we are aiming to improve our strategic positioning and return on capital employed.

You were talking specifically about Mexico, I think. In Mexico, we are focused on organic development and improving the return on capital employed in our operation. We are focusing in the 26 biggest metropolitan areas of the country, covering the rest through roaming agreements and franchises. We are in Mexico the only non-incumbent mobile operator that has positive OIBDA and operating cash flow, which is a differential for our asset. But at this moment, our performance is suffering from the change that we had in the interconnection regulation.

We are open to roaming agreements. We are open to franchises. We are open to agreements with other players. And we continue to monitor all strategic alternatives. But we are focused in the organic development of our business, in securing the value of our business. We will explore all the optionality with respect to other potential alternatives. I don't know if you were interested in some other geography.

David Wright – *Bank of America Merrill Lynch*

No, I think that's fine. And then maybe just my second question. We obviously saw the wholesale revenue line deteriorate with the MVNO loss. Can you tell us whether that was a full quarter's impact? Should we expect the same kind of drag through the rest of this year?

Ángel Vilá – *Chief Operating Officer*

Yes. Well, the different components of the wholesale line are known. On the one hand, you have the negative coming from the loss of the MásMóvil MVNO and MTR price cuts. And this is mitigated, but not fully compensated, by the growth in NEBA fibre wholesale, TV wholesale and roaming revenues. This will be the trend for the whole year.

But what is important, as you must have seen in the first quarter results, is that the positive trend that we're having in B2C and the improving trend that we're having in B2B more than compensate the decline that we are going to suffer this year on the wholesale line. So, Spain is back to service revenue growth, is actually accelerating the services revenue growth. And Spain is in OIBDA growth and accelerating from the previous quarter as well, the OIBDA growth.

So we are managing through a very good traction in B2C, which, by the way, is seeing reduction in churn in all its lines, and an improving trend in B2B. We are managing to compensate for the impact that wholesale line will have in service revenues this year.

Mandeep Singh – *Redburn*

Given your commentary around the different business lines in Spain, and I know you don't give single country guidance, do you see the sort of current trends as roughly sustainable, near around the 40% margins in Spain, and service revenues to stay in the positive territory for the remainder of the year? I accept there are quarterly movements here and there, just directionally speaking.

And the second question I have is on the UK. It wasn't that long ago you deemed that this asset wasn't strategic, and it was up for sale to somebody else; that deal got blocked. And now you're saying, yes, it is strategic. I'm just sort of trying to understand, other than the fact that the regulator blocked the sale, what's changed your mind to make the asset strategic versus non-strategic before?

Ángel Vilá – *Chief Operating Officer*

Your first question is becoming a classic one now in these calls. As you know, we do not guide revenues by regions, and we don't guide by quarters. But, as you can see, B2C service revenues have been steadily improving throughout the last quarters. We have been seeing first quarter in which the promotional activity was not there, lots of rationality, and "more for more" moves by most players. We have seen increases in volumes, and we are seeing increases in prices, with reduction in churn. These are good trends.

In B2B, the trend should be better, because growing IT revenues will mitigate the traditional communications decline. And we will continue to sell more digital services: IoT, cloud, security, these types of services. We will be aiming for stabilisation in B2B, which already is showing a very good improvement. In Q4, B2B was declining -2.6%. In this quarter, it's -0.6%.

And then Wholesale and other, I already commented in a previous question.

There is also differential factor this year versus last year, which is that handset sales are getting more traction on more commercial activity.

So we do not guide on revenues, but we are reasonably optimistic.

With respect to the U.K., we think we have the best mobile asset in the UK. We have probably the best management for a mobile company in the UK. Our performance is displaying this: we have (even when having some capacity problems) been able to maintain the best customer satisfaction, to maintain the best customer loyalty in the market. And we're experiencing margin improvement while we grow also our revenues. So, we are happy with this company. Regardless on how the market may evolve in the coming years, to own the best mobile franchise in the UK, we think it's a very valuable position to be in.

Keval Khiroya – *Deutsche Bank*

On Spain, there were some recent press reports saying that you could launch a new low-end brand after summer. Can you talk about whether you're happy with the current brand strategy, whether you think "Fusión #0" is serving alone sufficiently? Or whether do you think there is a role for more brands within your Spanish business?

And secondly, going back to the question around Latam and your return on capital there. I think Chile and Peru are 2 markets which have been reshaped by the smaller players and new entrants the past few years. Do you think there is any scope for consolidation in those markets?

Ángel Vilá – *Chief Operating Officer*

Regarding the possibility that has been speculated in the press about a potential new brand, at the moment, Movistar and Tuenti are suiting all market segments. We are getting good traction on both brands, which are positioned at different segments of the market, without cannibalising or competing against themselves. But we constantly work to improve our offer segmentation, to provide to all of our different types of customers with the most appealing and competitive products and differential customer experiences. Nothing has been decided on this front so far.

And then I think you were talking about Chile and Peru and the possibilities of consolidation. In those markets, we are focused on organic development. These are two markets that have suffered a lot of pressure from new entrants. We think that the situation in both is different. Potentially, Chile may have touched the bottom, and we are seeing very encouraging developments on Chile.

Peru is still in a more competitive position. However, we are back to positive commercial traction in Peru, in terms of net adds in mobile, in terms of portability. And we continued to have a strong fixed performance in Peru. Turnarounds normally start by better commercial traction, which then turns into better revenue traction, which eventually, through efficiencies, transforms into better profitability. But it's still in early stages in this turnaround. But, we are seeing the commercial good part in mobile, and we'll continue to be strong in fixed.

It's difficult to speculate about potential consolidation in those markets. We always monitor developments that can result in better value for our operations in the markets where we operate. But at this stage, we are focused on organic development.

Georgios Ierodiaconou – *Citi*

So, the follow-up question is around Chile and Peru. There is a change, as you mentioned, of your commercial approach. In Peru, in particular, if I'm not mistaken, the margin of 20%, even if we strip out mobile, will imply fixed line margin of around 40% and mobile of around 0%. So, I was just trying to understand from your perspective if there is a scope for margins to start stabilizing, you mentioned the commercial improvement. Or whether you think you may need to go into negative territory margins, which is where your competitors are, in order to stem the mobile competition.

And then my question on Germany is just to get an understanding of the partner revenues. O2 yesterday reported a significant slowdown. And obviously, there is significant growth in usage of partner revenues, both within the MBA contract and from some of the other partners you have in aggregate. And I understand it's difficult to comment on a specific contract, but for the wholesale revenues as a whole, is it possible to give us an idea of whether you are expecting a further slowdown, perhaps even a decline, or whether you believe this is a temporary phase? And even the significant growth in accesses you're seeing there, there should be a reacceleration at some point in the next few quarters?

Ángel Vilá – *Chief Operating Officer*

First, on Peru, let me give you some more colour. As I was telling as a response to the previous question, we are turning around commercial trends in Peru. Let me give you some figures. In post-paid, we are in positive net adds after 7 quarters. In prepaid, we're also in positive net adds. We are in positive net portability. In fixed, where I was stating that we maintain our strong position, we are focused in cable development with record fixed broadband and pay TV gross adds. Pay TV accesses posted a 9% year-on-year increase, and fixed broadband a 7% year-on-year increase. So, we are having very positive commercial traction.

Prices continue to be under pressure, especially on the mobile side, and you can see this in the revenue evolution. And OIBDA, I think you were talking about the margin. OIBDA has taken a decline, and the margin has been reduced, but we are still at 19.6% OIBDA margin.

So, I think this is an example, or a reflection, of how our Peruvian colleagues are managing, not only to reactivate activity on the commercial side, but also to work very strongly on efficiency measures to maintain the profitability of the Company. Which by the way, is generating positive operating cash flow, in spite of accelerating part of their CapEx. We don't think that we need to erode OIBDA margins to the levels that some of our competitors are displaying, because we have already been working for a few quarters on this Peruvian turnaround. And now it's starting to show the signs.

With respect to Germany, and I thank you for the question, we believe that yesterday's concerns regarding this topic were overdone. Probably because we didn't explain ourselves well enough yesterday. According to our German team, the B2P segment in Germany is in good health, with positive commercial traction and financials growing year-on-year. We are seeing higher migrations to the MBA contract that will derive additional revenue opportunities in the future.

And at the same time, we are optimizing low-margin service providers, including shifting some business to own customers. This internalization of reseller into own business is neutral on top-line and neutral-to-positive on OIBDA. But in any case, what created the concern yesterday is a negligible effect on OIBDA.

Telefónica Deutschland Finance and IR departments stand ready to give you all the additional proper explanations you may need. But again, these concerns are, in our opinion, overdone, and the B2P business is doing just fine.

Akhil Dattani – *JP Morgan*

Two questions from me as well, please. First, on Argentina. If we look at the last 5, 6 years, we've had sort of a compound 20% currency pressure each year. Despite that, if we look at the euro-denominated financials, you've managed to keep a broadly stable EBITDA performance of about 1 billion euro. So, I guess just keen to understand, what are the moving parts here? How sustainable you think it is? Is it down to underlying price increases? Are there any accounting issues on that? So, just what is your view on that.

And then the second question was on the U.K. You've talked about the U.K. strategic. I guess what I'm trying to understand within that is, firstly, operators in the market are introducing CPI-based price increases. So, is it partly down to revenue outlook, can you comment on that? Is that partly down to what's making more comfortable? And linked to that, you are still talking about "IPO-ing" the assets. So, I guess keen to understand if it is strategic, what is the merits and rationale behind considering an IPO?

Ángel Vilá – *Chief Operating Officer*

First, on Argentina. To summarize in a sentence, Argentina is growing very strongly even when converted into hard currency. We are managing to grow the revenues through price increases, through higher consumption, to grow in high-value customers both in fixed and in mobile. We're managing to achieve, talking historically, because I cannot talk forward looking on this asset, we are managing to grow above inflation. And also, efficiencies are allowing us to grow costs below inflation. So, our OIBDA is again growing above inflation and this is what is allowing for us to have a performance that, in spite of the FX evolution, is allowing our Argentina asset to be growing, and growing strongly even when converted into hard currency.

With respect to the U.K. again, the company, is performing nicely on the commercial front. In a market, which overall is not growing that much, we are managing to grow our customer base. We are improving our ARPUs. We are having the lowest churn in the industry. So, we have a strong customer base. In our revenues, there is impact from items like CPI. Also, as you saw, we are expanding margins in OIBDA. Part of that has been from the reduction in annual license fees, but also the revenue traction and efficiencies are building into that, and the company generates substantial cash flow.

So, we think it's in a very attractive asset. Again, in a market that we believe is at the forefront of the digital customer revolution in Europe. And for us, it's a strategic asset. The merits of a potential IPO, if market conditions were there: this Company can grow faster depending on how the market evolves in the future. Being listed company, can provide strategic and financial flexibility. And proceeds from such potential IPO would also be helping in our continued and recurrent effort to improve our balance sheet at the group level.

Julio Arciniegas – *RBC Capital Markets*

Two questions on Spain. So the first one. Based on the Spanish regulator, Telefónica's broadband net adds in January, actually, they were quite strong, 18,000 net ads. However, Telefónica ends the quarter with losses, I think like 6,000 net adds. Hence, it looks like competition landscape in Spain has increased after January. Can you give us some colour on what are the drivers that has made like a very good start for Telefónica in January to lose these subscribers by the end of the quarter?

And my second question is regarding the comments on football rights. ARPU in Spain has been increasing with More for More, for example, giving football to customers. In the case the company decides not to renew the football rights, as it has been commented, how will the company avoid churn increase? I would think that, actually, the satisfaction from the consumers will actually drop if that happens. And also, don't you think that, actually, this move might benefit operators like MásMóvil?

Ángel Vilá - *Chief Operating Officer*

On your first question, I would draw your attention to Slide number 12, where you can see at the top right that we've had very positive commercial traction in the quarter in fibre, in NEBA fibre, in TV, in mobile contract; and slightly negative, as you said, in fixed broadband. You should take into account that this fixed broadband is composed of fibre, but also is composed of copper.

So, as you would imagine, through migrations and through normal commercial activity, and given the very strong offering and coverage that we have in fibre in this country, customers are taking up more and more fibre, either directly from us or through some of our competitors to whom we wholesale. And they are doing less of DSL and copper. So fixed broadband, which includes both, is declining. But fibre, which is the important part of this, is going up. And there was potentially some mishap in the publication of figures by the CNMC.

With regard to your second question on soccer. As you can imagine, we are simulating all type of scenarios. We're simulating scenarios of what would be the economic impacts for us and for our main competitors if none of us had the soccer, if all of us had the soccer, if we didn't have the soccer but some other players had the soccer. And we are simulating all of these scenarios.

We have the biggest base of TV customers in Spain. We have lots of data; about the number of customers, which consume which type of content… So, we have a very good visibility on how to assign profitability to the different scenarios. So, you must be assured that we are running all of these scenarios, that we are making all these simulations and that we are factoring all those into the decisions that we will need to take in the coming months on potential soccer rights auctions, where, again, we will be very rational. I already said that the Champions League content is attractive at the right price. La Liga is attractive at the right price. So, we will be applying very strict economic cost-benefit analysis to those decisions. And we are simulating what could be the impact and the situation with respect to different scenarios, not only regarding current telco players, but if eventually, which has been rumour and we have no certainty, some over-the-top players were also bidding for those rights.

Julio Arciniegas – *RBC Capital Markets*

Okay. If I make a fast follow-up, so I get it right. So, the publication of the Spanish regulator is not correct about the broadband net adds of January of Telefónica?

Pablo Eguirón – *Global Director of Investor Relations*

It was wrong in January.

Samuel McHugh – *Exane BNP Paribas*

First one, on O2 U.K. I just wondered if you could share what the book value is, and whether if you did an IPO or if you did do a sell, whether there would be any tax implications?

And secondly, you raised an impressive amount of financing in Q1, EUR 10 billion, I think you said. What can you say about the rate at which you're raising financing year-over-year? Has there been a bit of pressure because of raising rates? How have the rates at which you are raising debt changed year-over-year?

Ángel Vilá – *Chief Operating Officer*

On your first question, I think we do not disclose the book value of our assets. And we cannot disclose, it would be premature, any tax implication. If there was a transaction to take place, which at this moment is uncertain, these impacts would be disclosed. But at this stage, first, it's uncertain, and second, there are some figures that we do not disclose publicly.

Samuel McHugh – *Exane BNP Paribas*

Just on financing. You raised EUR 10 billion of new debt in Q1. And I just wondered what the rates were like year-over-year? So, compared to the debt you are raising this time last year, has the average cost of interests gone up or down, or is it broadly stable?

Laura Abasolo – *Chief Financial and Control Officer*

We couldn't understand the question at first place. As you've seen throughout this quarter, we've been very active in refinancing. We have refinanced with issues of EUR 10.7 billion. As a result of that, we have continued to lengthen our average life of debt to over 9 years. We have continued to increase the fixed component to 72%.

So far, our payment costs in the first quarter is around 3.5% in cash terms. That's fairly similar to last year, which was 3.48%.

Also, when you look at the difference between the payment and the P&L this quarter, we are having in payment all of the coupons of some bonds that we issued in the first quarter of 2017. So it's not going to be with that amount of payment coupons throughout the remainder of the year.

We will continue monitoring credit markets, diversifying the investor base and selecting the right timing. But we think that with the amount of activity we've done throughout these 3 months of the year, we will be more calm thereafter for the remainder of the year.

Nicolas Didio – *Berenberg Bank*

One question would be regarding your credit rating with Moody's. I mean, the credit ratio shows that you should be upgraded, but still, you are at Baa3. I was wondering what could be the impact on your refinancing should Moody's upgrade your rating.

And the second question would be on your Spanish content and the upside from wholesaling that content to Latam and potentially to Netflix. Can you give us a bit on an update on potential discussions you may have there?

Laura Abasolo – *Chief Financial and Control Officer*

Yes. We are quite comfortable with the credit ratings outlooks at the moment. We are, in the 3 cases, in stable outlook. Obviously, we will like an improvement from Moody's. I cannot deny that, but credit ratings are comfortable, with our strong free cash flow generation last year our net debt deleverage is focused on organic growth, but also some inorganic movements, as we did last year with Telxius. And they are also happy with the hybrid activity. So we are quite comfortable with the stable outlooks we have at the moment. And we go through regular yearly meetings, and we just have gone through the meetings with the 3 of them in the last months.

I can tell you that we don't think Moody's rating is affecting at all our access to markets. As you have seen, we've been very active this quarter, not only in the bond front, also in the syndicate facilities. We have achieved a very competitive cost, so we believe our investment grade rating is good enough for the access of the market. And I think the numbers we show in the presentation today prove that it's not having any impact to the best of our knowledge.

Ángel Vilá – *Chief Operating Officer*

And regarding owned content of Telefónica: First, “Movistar #0” is the most viewed Pay-TV channel in our platform after “beIN”, the soccer. We are also producing contents in motor, in MotoGP and Formula One, which are increasing significantly their audiences. And we are enjoying, at this stage, those in exclusivity.

We are having excellent acceptance of our in-house series among Movistar customers. And this, not only in Spain, where we are having very good traction, but we're also going to be selling these abroad. Movistar Series will arrive to 13 countries in 2018. We are aiming to reach, in addition to the close to 4 million pay-TV customers in Spain, viewing series, more than 3 million in Hispam. And eventually, through over-the-top platforms, we can reach our more than 110 million Movistar mobile customers in Hispam.

Some costs will be recovered through foreign distributors as well, probably not to competitors in those geographies, where we would aim to have that content for us. But our ambition is to recover 20% of series costs via those foreign distributors.

And finally, also in own-production, eSports, although it's still new-born, it's already getting lots of traction, and we are the main reference on this.

So we are happy with our original production. It's giving us differentiation and lots of traction with customers. And we are being able to leverage it across our Latin American footprint quite successfully.

Nicolas Didio – *Berenberg*

Can I ask a third one? Just I was looking at one news on Bloomberg, quoting the extension on the long-term incentive plan and kind of the 5-year plan. I mean can you give us a bit more colour? You mentioned TSR. Will it be relative, absolute? What kind of targets do you set?

Laura Abasolo – *Chief Financial and Control Officer*

Yes. The long-term incentive plan needs to be approved by the AGM. We had plans of that kind in the past as well. We haven't had those plans for the last 2 years. It's a 5-year plan what we are taking for approval. And in order to have the shares for the employees, it has to be a combination of the Total Shareholder Return, together with free cash flow.