Telefónica January-December 2018
Results Conference Call Transcript

21st February 2019

Important Notice:

Although we try to accurately reflect speeches delivered, the actual speech as it was delivered may deviate from the script made available on our website

Introduction

Pablo Eguirón – *Global Director of Investor Relations*

Good morning, and welcome to Telefónica's conference call to discuss January-December 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 fourth quarter 2018 has been prepared under international financial reporting standards, as adopted by the European Union. From the first of January 2018 we 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.

This conference-call webcast (including the Q&A session) may contain forward-looking statements and information relating to the Telefónica Group. These Statements may include financial or operating forecasts and estimates based on assumptions or statements regarding plans, objectives and expectations that make reference to different matters. All forward-looking statements, involve risks, uncertainties and contingencies, many of which are beyond the Company's control.

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 Chairman & Chief Executive Officer, Mr. José María Álvarez-Pallete.

Mr. José Mª Álvarez-Pallete - *Chairman & CEO*

2018 Highlights

Thank you Pablo. Good morning and welcome to Telefónica's fourth quarter and full year 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 opportunity to ask any question you may have.

Let me start with 2018 main achievements.

First, we continue gaining customers' relevance, providing them with a top digital experience. Demand from more valuable customers is unabated and churn management translated into higher customer lifetime.

Second, we are transforming our revenue mix, increasing the weight of high growing revenues, as broadband connectivity and services beyond connectivity. During last year we again created several unicorns, that are already contributing to our growth.

A third highlight is that we continued to invest to put the best technological platforms at the service of our customers' needs, positioning us as pioneers in digitalisation, simplification, virtualisation, and artificial intelligence, that puts us at the forefront of technology in our way towards a cloud telco.

Fourth, sustainable and profitable growth is in our DNA. Growth trends accelerated from revenues to Operating Cash Flow, resulting into robust and sustainable FCF, as we continued increasing an efficient use of our resources.

Fifth, our net debt has been reduced steadily, for the 3rd consecutive year through ample organic FCF generation and reshaping of our portfolio via inorganic actions.

Finally, a reinforced balance sheet makes it compatible with a sustainable and attractive dividend, in line with our commitment to return value to our shareholders.

2018 proof points backing up our strategy

Moving to slide 2, let me go over the main proof points achieved in 2018 that back up our strategy.

- Double digit growth in FFTx/Cable and LTE accesses, with stable churn levels.
- Best ever Customer Satisfaction Index.
- 53% of our revenues already come from Broadband and Services Beyond Connectivity.
- Digital Revenues topped 7 billion euros, +24% vs. 2017 in organic terms.
- We remain leaders in FTTH deployment in Europe and Latin America, whilst being number 1 in network virtualisation and legacy shutdown.
- All this matters is translated into growth: we are growing our revenues, OIBDA, EPS and Operating Cash Flow. Furthermore, our FCF ex-spectrum of 5.6 billion euros is 5.3% higher than in 2017.
- It is FCF generation, coupled with our ROCE-driven focus, that allows us to bring down debt (as much as 3.8 billion euros reduction from 2017 levels, including post closing events), while we maintain an attractive, albeit prudent dividend pay-out ratio of 42%.

Last 4 years: organic growth; growing cash; reducing debt

On slide number 3 we show that this sustainable growth story goes back in time.

In the last 4 years, we have carried out a deep business transformation, simplifying, investing and transforming our revenue mix and customer base, towards a more sustainable business model.

As a result of this, our revenues have consistently been growing in organic terms while our OIBDA margin has consistently expanded.

Operating Cash Flow, the most sustainable source of cash flow generation has been growing in absolute terms from 4.4 billion euros in 2015 to 8.3 billion euros in 2018 ex-spectrum. Furthermore, and no matter the significant investment effort we continue to undertake, our free cash flow reached almost 5.6 billion euros in 2018.

And finally, we have been able to reduce our net financial debt by almost 9 billion euros including post-closing events. And we have been able to do so while paying attractive dividends to our shareholders.

Financials in a nutshell

Turning to slide number 4, we can see growth across main financials both in the fourth quarter and in the full year.

It is worth highlighting the sequential improvement in growth trends observed in the fourth quarter both in terms of revenues and Operating Cash Flow, that organically grew respectively by 3% and 31% year-on-year. Spain and Brazil, our two biggest operations, are large contributors to this quarterly improvement. FCF boosted to almost 2 billion euros in the last three months, to reach 4.9 bn euros in the January-December period even after including spectrum.

On a full year basis, growth has been profitable and consistent, as revenues grew annually by 2.4%, OIBDA by 3.5% and OpCF by 8.0%, with OIBDA margin expanding 0.3 percentage points.

In reported terms, headlines are impacted by negative fx swings and regulation, hyperinflation in Argentina and other special factors, that Laura will detail later on.

However, even on a reported basis, net income surpassed the 3.3 billion euro mark, an increase of 6.4% vs. 2017, while net financial debt declined 5.5% to 41.8 billion euros.

Delivering on our commitments

Turning to slide number 5, we have ticked all the boxes in terms of last year's guidance.

Revenues increased by 2.4% y-o-y in 2018, ahead of the guidance of "growth of around 2%", that was upgraded at mid-year, and despite regulation dragged 1.1 percentage points. OIBDA margin expanded by 0.3 percentage points, also in line with guidance, with regulation deducting 1.7 percentage points to OIBDA final growth. Finally, CapEx to sales stood at 15.1%, fully aligned with the guided level of "around 15%".

In addition, we accomplished with the goal of additional deleveraging and further strengthening of our balance sheet.

We confirm our 2018 dividend, with the second tranche of 0.20 euros per share to be paid in cash in June 2019.

Our platforms make us relevant to our customers

Moving to slide 6,

Telefónica is a Company of smart platforms. Starting from the bottom of the page, our first platform ensures the best connectivity. Our leading network in fibre covers already 83m premises with UBB and 76% of the population with LTE. We are also number 1 in network virtualisation with UNICA infrastructure deployed in 11 countries and the transformation of the core led to 40% reduction in the past 2 years in CapEx needs.

In the second platform, we progressed deeply in 2018, having 65% of the processes digitalised and managed in real time, 30% of our customers migrated to full stack and 66% to Online Charging System.

The third platform provides innovative and personalised products and services, with segmented offers in the residential business and complete B2B solutions, delivering up to €6.8bn digital revenues in 2018, a 24% year-on-year increase.

Up to the fourth platform, we integrate artificial intelligence and open platforms to improve the way we engage with our customers and make internal decisions. Moreover, our cognitive intelligence, Aura, is now available in 6 countries.

I now hand over to Angel to take you through a detailed review of the business performance.

Mr. Ángel Vilá - *COO*

Ongoing strong momentum

Thank you José María.

Fourth quarter confirmed the ongoing operating momentum, with revenues and OpCF annual growth improving sequentially. Revenues accelerated 30 basis points from the previous quarter, with all regions performance improving, with a particular mention to the sequential improvement seen in service revenues in Spain and Brazil. Revenues in current euros reached 12.9 billion euros vs. 11.7 billion euros in the third quarter. And revenue growth would have been 3.9% excluding regulation.

OpCF posted as well an outstanding performance, growing by more than 30% in the fourth quarter on a year-on-year basis, while OIBDA grew 2.4% year-on-year. In the full year, OpCF grew by high single-digit as CapEx declined 1.3% in organic terms.

B2C | Enriched portfolio, video and data boost growth

In slide 8, we saw how we are continuously enhancing our value proposition to make it simple, reliable and efficient for our customers.

In the consumer segment, all regions are delivering organic revenue growth in 2018. We bring on board more customers who are more loyal and uplift ARPUs, by means of superior convergent offers (pioneering now in Perú and with richer in content in Spain and Latam), personalised and flexible offers in postpaid (with data sharing or OTT Video) and more data recurrent plans in prepaid.

As such, we are monetising better our offering and are growing revenue with a larger base of Video subscribers (+5% vs. 2017) to almost 10 million, and increased base of fiber customers (+20%) and a larger percentage, 43% of Latam mobile customers using data.

B2B | Differentiated proposal, relevant and distinctive growth engine

In slide 9, we show a snapshot of our B2B segment, a very relevant piece of business that is also showing very encouraging trends.

We have all the capabilities to be a first player supporting the transformation of clients' businesses. We have built a Lego-like portfolio, based on a Digital Core proposal (with Comms, IoT and Cloud) and a complete ecosystem of leading digital services to be added on top of it.

This is all underpinned by our global reach and making differentiated value proposals for multinationals, Corporates or SMEs.

As a result, B2B revenues topped 9.6 Bn euros in 2018, growing at a healthy pace of 3.4% year-on-year and accounting for 20% of total Group revenue.

Both Corporates and SMEs are growing, by 5.3% and 1.8% respectively, and the contribution of the Advanced Digital Services, namely Cloud, and IoT is worth to mention, both increasing at double digit.

All in all, we are a reference with a distinctive positioning to capture the large growth opportunity ahead of us.

Digital Transformation | Customer at the centre

In slide 10, you can see how the deep transformation of our business model is starting to deliver relevant savings, more than 300 million euros in 2018.

We have introduced new ways of working, with 40% of savings coming from initiatives related to Customer service in Digital Channels (as fostered use of apps); 30% from Digital Experience in Sales (thanks to Advanced Analytics and personalised sales); 20% from simplified & trustful processes in Billing & Payments, specially in

Latam; and the remaining 10% from Process Automation such as resolution of incidents and "robots factories".

Moreover, in Telefónica we continue progressing on further digitalisation, already with an Agile mindset, and we expect to deliver more than 340 million euros of incremental savings at the end of 2019, reaching more than 1.0 billion euros of cumulative savings by the end of 2020.

Spain | Competitive differentiation in a rational market

Moving on to Spain, slide 11 shows how our unique and differentiated offer takes us steps ahead of competition.

In 2018 we have grown our convergent customer base by 9% year-on-year, TV customers +6%, FTTH accesses +15%, whilst contract mobile customers +7%.

All this, under controlled churn levels whilst increasing convergent ARPU, which despite no tariffs update taking place grows by more than 4% year-on-year in full year, to 89 euros. This is more than 50% higher than our closest competitor within the convergent market, fueled by increased differentiation.

We can thus conclude that both our revenue and value share are expanding.

This is the result of a very clear strategy. An unmatched network (having passed already 21.3m premises in the Spanish market) and differential TV offer (as an example, we are direct owners of Champions League rights, whose audience is increasing by about 90% year-on-year so far this season), that allows us to further raise Pay-TV uptake, driving ARPU up and churn down.

Spain | Improved delivery: revenue acceleration, stronger cash

On slide 12 we can find the financial consequence of what we just went through.

Service revenues grew year-on-year in Q4 18, to +2% once excluding MTR and MVNO negative impacts. This is a remarkable 0.6 p.p. sequential improvement.

Aside from the already mentioned improvement in Consumer revenues, namely convergence driven, growth improvement also lies on much better "Business" performance (+3.5 p.p. from the previous quarter) on record IT sales & flat communications.

We are confident on further tailwinds namely (tariffs update and promos expiry in B2C, IT and digital services in B2B, TV and easing regulation/MVNO impact for wholesale) allowing to accelerate this positive revenue trend into 2019.

We were able to post benchmark organic OIBDA margin of c.a. 40%. in 2018, which together with declining CapEx, down 5.1% year-on-year in 2018, allowed for OpCF annual growth of 0.6% to 3.5 billion euros, 11% higher in Q4 than in the same period last year.

Year-on-year organic OIBDA evolution slightly worsens vs the previous quarter, despite revenue better performance. Growth in net content costs, primarily related to one-offs calendar effects, which will disappear as from Q1 19, is the main reason behind such performance.

Going forward, OIBDA evolution throughout 2019 should be favored by the above mentioned progressive improvement in revenues and lower content cost growth.

Germany | Network integration largely finalised

Moving to slide 13, Telefónica Deutschland continued to show positive operational momentum in the fourth quarter. The innovative O_2 Free tariff portfolio with “Boost” option and the unique “O_2 Connect” continued to stimulate data usage and drive data monetisation.

During the quarter, the Company registered 279 thousand contract net additions, 50% up year-on-year. LTE customers amounted to 18.4 million, up 17% year-on-year, with LTE penetration reaching 44%. Average data usage of O_2 contract LTE customers was up 47% year-on-year to 4.1GB per month. Customers on O_2‘s most popular tariff “O_2 Free M” reported an even higher average data consumption of 6.5GB per month.

With regards to key financials in the quarter, revenues are up 2.6% year-on-year mainly supported by strong seasonal handset sales up 24.2%. OIBDA was down 4% year-on-year mainly due to capital gains from the sale of asset in Q4 17, lower incremental synergies and regulatory impacts.

For the full-year, CapEx increased by 1.7% year-on-year driven by the now largely finalised network integration and ongoing LTE rollout also reflected by significant quality improvements achieved in the latest published network tests. The Company generated Operating Cash Flow of 868 million euros.

UK | Consistently outperforming the market

Turning to slide 14,

Telefónica UK maintained its market leading position with 32.6 million mobile accesses. The ongoing success of “Custom plans” has been one of the key drivers of O_2’s strong commercial performance. The Company also continued being the UK’s favourite mobile network with sector leading loyalty evidenced by the lowest postpay churn in the market at an unchanged 1.0%.

Telefónica UK delivered the 10th consecutive quarter of MSR growth and was up 2.9% year-on-year.

In the quarter, accelerated OIBDA growth of 23.8% year-on-year resulted in margin expansion of 3.8 percentage points year-on-year. A stellar performance once again.

At the same time we continued to invest in our network, for example, through rapid deployment of the awarded spectrum. For the full year, CapEx is up 7.1% year-on-year organically while Operating Cash Flow strongly improved by 16.5%.

Brazil | Strong operating momentum

Moving to slide 15,

Vivo ends 2018 with an outstanding commercial performance, capturing valuable growth opportunities thanks to a combination of superior assets.

- In contract, mobile net adds reached 3.6m in 2018, increasing 7% year-on-year and maintaining similar churn levels vs. those seen in previous quarters.
- In prepaid, and as planned, the new commercial offering started to post positive results in Q4, improving year-on-year revenue trend by 5 percentage points vs. the previous quarter. Along with an improved macroeconomic environment throughout 2019, we are confident that this positive trend will continue going forward.
- Regarding our fixed operations, we continue accelerating the transformation of our business, having covered 30 new cities with FTTH technology in 2018, already reaching 8.7m premises passed.

- Average take-up ratio on this improved network stood at an outstanding 42% for premises passed in 2017, leading to a solid ARPU growth in FBB and Pay TV of 11% and 4% respectively during 2018.

Brazil | Best quarterly OIBDA margin ever

On side 16 we can see revenue reversed its trend in Q4, returning to positive year-on-year growth thanks to the already mentioned improvement in prepaid, and the remarkable growth seen in contract (+7%), fiber (+27%) and IPTV (+59%) in revenues.

Furthermore, the ongoing simplification efforts and the benefits of the digitalisation initiatives translated into the 12th consecutive quarter of year-on-year OpEx reduction. It is worth highlighting that in cumulative terms VIVO has been able to bring down its OpEx base by 4.5% since 2016, which compares with cumulative inflation in the same period of 13%, making this effort even more remarkable.

As a result, organic OIBDA margin surpassed 39% in Q4, the best OIBDA margin ever for our Brazilian operations.

Finally, FCF reached an unprecedent level growing 30% year-on-year to 1.5bn euros in 2018, in spite of intense capital deployment, with CapEx over revenues of 19% in 2018.

South Hispam | Sustainable growth in a difficult environment

In the South Hispam region, on slide 17, we continue growing in value despite the tough competitive environment we are facing, mainly in Peru and Chile:

- Contract accesses rose 5% year-on-year, posting positive net adds for the 5th consecutive quarter.

- FTTx connections increased 50% after accelerating their deployment with 2.1m premises passed in 2018.

- Pay TV accesses grew 8% year-on-year, and it is worth highlighting the sound performance in Peru and the launch of this service in Argentina in October.

This commercial performance, coupled with efficient OpEx management and the benefits of digitalisation resulted in a healthy growth of 9.6% and 8.1% in revenue and OIBDA, respectively, during 2018.

North Hispam | Regulation and competition dragging growth

Moving to slide 18 we review North Hipam operations.

In Mexico, financial performance continued to be strongly affected by regulation and by the sharp pricing pressure seen in the market as a result of strong competition. However, we were able to grow in both contract and prepaid in Q4 after recent changes in offers in both segments.

On the other hand, Colombia continued showing a stellar performance, with accesses growth in its main services, especially FTTx, where connections more than doubled vs. the previous year. This sound commercial performance and implemented efficiencies led to OIBDA grow by 28% year-on-year in the fourth quarter.

As a result and despite Mexico headwinds, OpCF in the North Hispam region increased by a remarkable 18% year-on-year.

Excluding Mexico, 2018 revenue and OIBDA grew 1.0% and 2.7% year-on-year, respectively.

Telxius | Crystallising value form premium infrastructure

On slide 19, Telxius continued growing its asset portfolio in the quarter, showing good traction in towers and gaining commercial momentum in cable.

The tower portfolio added 291 new tenants in Q4 and improved the tenancy ratio by 0.03 year-on-year.

In the cable business, it is worth mentioning the ongoing capacity sales in both BRUSA and MAREA, resulting in agreements such as the one signed in MAREA cable in January 2019 with Amazon Web Services.

Regarding fourth quarter, revenues increased by 5.5% year-on-year and OIBDA did so by 6.3%, mainly driven by the tower business and on the back of efficient cost management. Thus, OIBDA margin improved by 0.4 percentage points year-on-year to 46.6%.

Full-year CapEx declined by 6.3% year-on-year after the completion of the new cables that came into service in 2018, resulting into Operating Cash Flow growth of 33.9%.

I will now hand over to Laura to take you through the details of the financial position.

Ms. Laura Abasolo - *CFCO*

Q4 OIBDA & Net income special factors

Thank you Ángel,

Please turn to slide number 20 to see in more detail the effects impacting the quarter.

These factors reduced OIBDA and Net Income by 472 million euros and 651 million euros respectively.

In detail, special factors are: 1) restructuring costs, mainly in Spain, 2) impairment in Mexico, 3) hyperinflation in Argentina, 4) capital gains and losses and other factors.

FY Net income surpassed €3.3bn; EPS €0.57

As you can see in slide number 21, net income surpassed the 3.3 billion euro mark in 2018, growing 6.4% vs the previous year.

We continued to manage successfully non-operating results, as our Operating Income declined by 4.0% in reported terms while Net Income year-on-year growth was mid single digit.

Underlying Earnings Per Share reached 0.81 euros per share in the year, growing 9% vs 2017.

Managing FX headwinds

Let me now update on slide 22 how we are managing FX headwinds.

Forex continued to deduct growth in revenues and OIBDA on a year-on-year basis, but this impact has been reduced in the fourth quarter. In addition, during this period hyperinflation adjustment in Argentina was positive.

In 2018, FX drag amounted to 4.3 billion euros in terms of revenues, 1.5 billion euros in OIBDA while negative impact was significantly reduced to 0.5 billion euros in FCF. Regarding net debt, the effect was the contrary and FX lowered net debt by 0.2 billion euros.

On top of that, let me remark that organic OIBDA contribution remained solid and consistent.

Strong FCF; mid-single digit growth in FY ex-spectrum

On slide 23, we can see that FCF reached almost 2 billion euros in the last quarter, growing by double-digit.

In 2018, it totaled 4.9 billion euros after including the UK and Spanish spectrum auctions. Excluding spectrum, it topped 5.6 billion euros, up 5.3% year-on-year. As you can see on the upper right hand-side of the slide main FCF driver is the improved business performance, along with lower financial payments.

On a per share basis, free cash flow reached 0.96 euros, though would have stayed at 1.09 euros excluding spectrum.

Free cash flow from our European operations, before financial payments, amounted to 0.85 euros, comfortably covering dividend, hybrids and total interest payments.

Steady net debt reduction out of strong FCF

Let's move now to the financial metrics on slide 24.

This slide shows how we continue to progress on our deleverage path, relying on a strong FCF generation coupled with inorganic measures, such as the disposals of Telxius, Antares and the operations of Telefónica in Central America.

Therefore we show a remarkable net debt reduction figure of €2.4bn in 2018, continuing with previous years trends and increasing to €3.8bn including post closing events.

As such, our net debt figure as of year end 2018, including post closing events, stands at €40.4bn.

Strong liquidity thanks to attractive long-term financing

On slide 25 we highlight Telefonica's extensive access to capital markets in 2018 and year-to-date taking advantage of historically low rates. It is worth highlighting that in January 2019 we issued a green bond, the first globally in the telecoms market.

By accessing long tenors, we have extended our average debt life to 9 years while we keep a comfortable liquidity position over 20 billion euros, exceeding next two years of maturities.

Our interest payments effective cost in the last 12m stood at 3.41% as of December 2018, being an attractive average rate level and 4 basis point lower than September 2018.

I will now hand back to Jose Maria.

Mr. José Mª Álvarez-Pallete - ***Chairman & CEO***

2019 guidance

Thank you Laura.

Let me now outline the guidance for 2019.

We aim for sustainable and profitable growth: revenue and OIBDA organic growth of around 2% despite regulation. CapEx ex-spectrum acquisition will be around 15% of sales.

For 2019 we are proposing a stable, sustainable and attractive dividend payment. This consists in 0.4 euros per share in cash payable in 2 tranches; the first in December 2019 and the second in June 2020 subject to the adoption of the corresponding corporate resolutions announcing the specific payment dates. Like this year, calendar year payments amount to 0.4€/sh.

Summary

To finish, please move to slide 27.

2018 was a year of continued focus and investments in transformation, which allowed us to lead the pack in terms of digitalisation, virtualisation and artificial intelligence. So, connectivity has been the foundation for upgrading our customer base and offering the best customer experience, with a clear drive towards UBB connections. All these translated into sustainable and profitable organic growth, leading OIBDA margin and further deleverage driven by robust FCF generation.

We are confident into 2019, when we expect to continue delivering growth and returns; leveraging on our differential assets and global capabilities. Networks are getting smarter and ready for the future, reinforcing our world-class network infrastructure and IT systems. Monetisation of our leading propositions will be key, digitalisation savings will give flexibility to reallocate resources across our footprint and management based on ROCE will allow us to increase returns.

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

Q&A session

Georgios Ierodiaconou – *Citi*

The first is just maybe if you could give us some clarity on the moving parts of cash flow for 2019. And I know you already highlighted the post-closing events. But there have been some tax decisions, I was wondering whether those will have any effect on the tax actually paid in the next couple of years. And then, the other moving parts around net interest payments, working capital, that are worth highlighting just to get an understanding of what to expect in 2019.

And then, my second question is around the operating performance of the group. Obviously, in the past, you were guiding for margin improvement progressively, not so this year. I understand there are higher content costs in Spain and Orange gave us some guidance before on some other headwinds they are facing. But if you could give us an idea of why some of the cost savings you are doing are not offsetting these and which markets will be the ones that may offset declines in margins in Spain perhaps and in Germany? And then if I could just ask a clarification on that. We've seen very dilutive performance of margins in Peru in the fourth quarter. If that is something that could turn around in 2019

Laura Abasolo – *Chief Financial and Control Officer*

Thank you, Georgios. Let's start with your question on free cash flow. As you know, we do not guide specifically nor formally on free cash flow. What I can tell you is the fact that we have achieved 2 consecutive years of very strong free cash flow, which has been the main driver for deleverage, above EUR 5 billion ex-spectrum both in 2017 and 2018. And in 2018, almost EUR 5.6 billion, growing 5%.

If we go into 2019, based on the guidance provided, which is consistent revenue and OIBDA growth and stable CapEx over revenue, you should expect again a strong operating cash flow performance, that, coupled with optimization of interest and cash payment costs should lead again into a very solid free cash flow, excluding spectrum. And the most important, comfortably exceeding dividend payments, labour commitments and hybrid coupons payments. Thus again, it's going to be a main driver and the more sustainable for the continuing deleverage.

Going to your specific question, on interest payment, I could tell you that it will still sit comfortably below 4%.

Regarding your question on the tax refund and the notification we have received from the Central Economic-Administrative Tax Court in January 2018, at this point in time, it's not possible to quantify the amount of the expected refund. But most likely, there will be a tax refund related to overpayments made by the company in the years 2009 and 2010, and that obviously will flow through free cash flow as well.

And regarding the closing of Central America and impacts in cash. Guatemala been signed and closed simultaneously, however, the remaining 4 operations are pending regulatory approvals, and therefore, we'll have operating cash flow from those operations until the transaction is formally executed.

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

Taking your question on the guidance globally, and namely on OIBDA. Let me start by saying that we expect to grow at a similar pace than in 2018. And in fact, regulation should drag less this year than in the previous year. Remember as well that we tend to be prudent. Last year, we started with a guidance of 1%. So, in comparable terms we are guiding for more growth year-on-year, so to say. And then, we upgraded mid-year when we were seeing our operational performance. Why are we guiding for OIBDA in absolute terms and not following the margin? First, because we want to have flexibility to invest in those markets where we see growth opportunities. But as an overall reflexion, we are guiding for around 2% growth in revenues and around 2% growth in OIBDA, which basically tend to imply a stable margin evolution. And that's decided because we want to be prudent, and at the same time, we want to keep flexibility to invest for further growth in the markets where we see this opportunity.

Ángel Vilá – *Chief Operating Officer*

Georgios, I'm going to address your several questions on, if I understood right, Spain, Germany and Peru margins.

Spain: in the fourth quarter, first, I want to highlight that it's back to growth. The revenues have been accelerating sequentially and they have been accelerating year-on-year. We have achieved for the full year an OIBDA margin of 39.8%, which in the fourth quarter has been of 38.9%. This was affected, and this had been flagged in previous conference calls, by higher content costs, by the B2B strength and also by the reduction in MVNO wholesale revenues. But, what I would want to say is that the decline in organic OIBDA that you see in the fourth quarter compared to the third quarter: 1/3 of that would come roughly from higher football costs, with a full quarterly impact of a new Champions League cycle, but 2/3 would come from others, basically the accelerated amortization of Moto GP rights, which were not renewed and have some calendar impacts in this fourth quarter that would not be repeated in additional quarters.

Going forward, what we see is, for our Spanish operation, that we can maintain an OIBDA margin at broadly similar levels as this year. Due to the content cost calendar, the first half margins will be closer to what we saw in Q4, but they will trend up in the second half. And in any case, what we are aiming at is to grow in Spanish OIBDA for 2019. It would be a slight growth, but growth nonetheless in the Spanish business in OIBDA in 2019, what we have not seen in prior years.

Moving to Germany. They announced results yesterday. You have seen the actuals, the OIBDA performance, which was conforming to their guidance, with an increase ex regulation. And they have guided OIBDA on a broadly stable to slightly positive ex-regulation for 2019.

And with respect to Peru, what we are seeing is the impact of a still strong competition in the mobile segment, strong commercial activity in the Peruvian market. We have, in Peru, been able to maintain on the fixed business and on the pay TV the strength that we had in the previous quarters. We are now launching full convergent offers in Peru, but we continue to see competitiveness in the mobile segments. So, commercial intensity. And also, commercial intensity that has some handset financing packages that are also impacting the OIBDA performance.

Keval Khiroya – *Deutsche Bank*

I've got 2 questions, please, both of which in Spain. So, when we look at the revenue trends of non-convergent revenues, we did see a deterioration in Q4 when compared to an already decline in Q3. Would you mind giving just a bit colour on that, maybe some comments on the direction? And following up for your comments on Spain on 2019 EBITDA, which were be very helpful. As you mentioned, we will see the higher football costs continuing in the first half. When it comes to actual cost savings which could help offset that, can you talk about whether there will be some additional rates of cost reduction beyond what you've already seen in 2018 to help offset some of these content cost pressures?

Ángel Vilá – *Chief Operating Officer*

Thank you, Keval. Our B2C business accounts for 53% in the fourth quarter of total service revenues, and it's growing at a rate of 1.1%. For the full year, it accounted to slightly a bit more of 54%, and the growth, you have it on Slide 12, of 1.3%. 73% of these B2C service revenue is in Fusión, which is growing very nicely at 7.1%, and the non-convergent revenues are declining by 12.3%. Here, the weight of the non-convergent revenues is getting smaller as we move forward. And here, you have still the impact of some single-play Pay TV customers that we had a decline and we still have some base. Some of those standalone customers are migrating to convergence, and this process is still underway.

With respect to the evolution of the elements of our OpEx or costs function, there are several pieces. On the one hand, the evolution of the content cost that we have been flagging in this call and in previous calls. We have entered into the third season of the previous La Liga cycle and we have the first season of the current Champions League cycle. On the other hand, we have been not renewing some other contents in our offer. So this means that net content cost is peaking. Compared to this, we also have additional efficiencies: we'll continue to have efficiencies in distribution channels. And here, we are seeing the benefits of digitalization that we are flagging in the presentation. We continued to have incremental savings from personnel redundancy program: they will achieve full run-rate in 2019, and we are seeing fewer people returning after the suspension, so this will result in a slightly higher run-rate than the one we had announced before. We have efficiencies from running the close to full-fiber network; the maintenance cost of fiber versus copper is less than 50%. We continue to switch off legacy. We have closed down 182 copper centre switches and we expect to have closed more than 700 switches by 2020. We'll continue to migrate our systems to full-stack. So all in all, again, we have confidence in an ability to grow OIBDA slightly in Spain in 2019.

Mathieu Robilliard - *Barclays*

Two questions, please. First, in terms of the macro environment in Latin America. You highlighted that you expect an improvement in Brazil. I realize all countries are different, but if you can maybe give us a sense of what you expect for the main countries in Latin America in '19. Basically, what is embedded in your expectations?

Second, with regards to asset sales, so you've sold most or all of your Central American operations or you're in the process of doing it, which is great. And I was wondering, is that it for asset portfolio reshuffling? Or in theory, conceptually, you would still consider or you're still working potentially on other disposals in the region?

José María Álvarez-Pallete López - *Telefónica Chairman & CEO*

Thanks for your questions. In Latin America starting by Brazil. We see a strong Brazil going forward.

In terms of macro volatility, we expect Brazil to grow in 2019 and depending on the level of reforms that the government (recently appointed) is going to be able to pass through the Congress, this growth can even be accelerated. Remember that Brazil has a significant amount of foreign reserves, more than $380 billion of foreign reserves, and has also been creating during the last 15 years a very strong middle-class. And therefore, internal consumption has become another driving force of stabilization of the economy.

So overall, Brazil, with the reforms we think it can be a positive surprise in the markets in terms of a decent growth, robust GDP growth; and it should help to stabilise the region because, at the end of the day, Brazil is the heart of Latin America.

In Argentina, we see volatility, mainly based on inflation-driven processes. We think that the reforms that the government is doing should finally help to have some stabilisation, so we have a better outlook for Argentina in 2019 than in 2018, and therefore, a better performance in terms of GDP.

A strong growth in Peru and Chile, and strong growth in Colombia as well.

So overall, we expect to have a more robust macro environment in Latin America this year compared with the previous one. And certainly, we should have less volatility in terms of FX, and namely, certainly, much less headwinds in terms of FX translation into our accounts.

And then, Venezuela it's a very big uncertainty, so I'm not going to be able to comment on the Venezuelan situation. It's binary.

So overall, our expectations embedded in our budget for this year is macro-economic growth in the region are driven by a strong Brazil, less FX volatility, and therefore, less impact, and therefore, less dilution of the growth translated into Euro terms for Telefónica.

And then moving into the portfolio management.

As we had stated three years ago, we are trying to be very consistent. We are not making any divestment just for taking debt down, it needs to make financial sense. We are not going to be destroying value by divesting.

We have classified our assets into categories, assets meaning geographies, infrastructure and products and services, and we have projected return on capital employed of each of those for the next 3 years, and we therefore we are benchmarking the capital employed derived from an organic management with any potential divestment opportunity or inorganic opportunity we may have.

And it is in that framework that you should frame the Central American discussion. We have been able to generate more value by integrating those in some of our competitors and grabbing part of the synergies that are going to be derived from this integration, and therefore, creating value.

Are we targeting more portfolio optimization based on capital employed? certainly yes, as well as we keep investing very heavily in our own networks and monitoring very closely any in-market consolidation that we can have and drive also. So, the answer is yes, return on capital employed portfolio approach certainly going forward and more capital and more portfolio optimisation to come.

Joshua Andrew Mills - *Goldman Sachs*

The first is on your Spanish wholesale business. I wondered if you could just kind of walk us through how to think about growth in this segment as you move into 2019, because clearly, it was under pressure in Q4, and I understand there's a couple of one-off items there. But it'd be good to get a sense of whether the underlying broadband wholesale revenues for the business are growing. I think you talked about a tougher comp year-on-year in the press release.

And then if next year, we've got a higher TV wholesale revenue, maybe a bit lower MVNO, but if broadband can continue to be upsold, is this going to be a positive contributor to the top line performance in Spain?

And then secondly, just on Brazil. It would be great to have an update on the regulatory situation there following PLC 79 headlines since. And whether you think that there is potential resolution to the concession set up in the market today within the kind of timeframe in 2019 and whether you think that is an opportunity to create more value in your second biggest asset.

Ángel Vilá - *Telefónica Chief Operating Officer*

Of course, we do not guide on OB's revenues, but let me talk a little bit about what trends we see for service revenue in Spain and will talk about wholesale.

As you know, B2C, which is more than 50% of our service revenues, has been consistently growing. We are seeing increases in volumes and ARPUs and we have some tailwinds going forward regarding to more for tariff updates and some end of promotions. So, we think that these trends will result in tailwinds in B2C.

Regarding B2B, we are growing in the last three quarters. The IT growth is compensating the communications evolution. We are selling more digital services in IoT and cloud security, so see also positive trend.

And then in the "wholesale and other", there are going to be changes in the revenue function. The MVNO loss that we saw this year will fade out during 2019, and we have recently signed an agreement with MásMóvil that will also help on the mobile side. We have agreements for migrations from copper to fiber wholesale, which will continue. And the content resale dynamics will be relevant because we have more content to resell to third-parties. Will this mean that the "wholesale and other" line will become positive? Probably not, but far less negative than what we've seen this year.

So, all in all, this should translate in service revenue acceleration in Spain in 2019.

And with respect to the approval from the concession authorization in Brazil, there what we see, or our Brazilian colleagues see, is that there are increased chances with the current political conditions that it can be taken for approval sooner rather than later, although we don't have any specific calendar.

Joshua Andrew Mills – *Goldman Sachs*

Can I just ask one thing on wholesale? So, we've talked about MVNO losses fading out. You've got the upselling from copper to fiber, and TV revenues are higher. So, what is it that we're missing that means revenue wouldn't grow? Is there just declining kind of transport and roaming revenues that we need to think about as well?

Ángel Vilá - *Telefónica Chief Operating Officer*

Well, you have the rate of movement from the wholesale from copper to fiber, part of that is moving to different types of unbundling of fiber, so you have what is the called the NEBA o NEBA Local (VULA) migration- the non-local access and local access to fiber- which have different prices, and these migrations with the wholesale agreement we've reached with Vodafone, Orange and so on is giving more weight to the local one.

And also, there is self-provisioning on fiber. So, it's accretive migration. The rate is clearly an improvement, but probably will not be enough to turn that line into positive.

However, the trends that we see in B2C and in B2B compared to this improvement in wholesale should result in a clear acceleration quarter-on-quarter on the revenues in Spain in 2019.

Julio Arceniegas – *RBC*

Today football in Spain is exclusive to Telefónica and Orange. And I believe that OTTs are planning to offer football as from the next season. How do you see the risk of losing this exclusivity or facing competition from OTTs?

And my second question is also related to this topic. I guess that if football is available for OTT, and there is a retail cost, let's say Orange might stop acquiring the football rights from Telefónica. Can you give us some colour on how the contract between you and Orange works? Can they basically walk out on any moment from the wholesale agreement for football, or do they have to stay for the 3 years?

Ángel Vilá – *Chief Operating Officer*

Thank you, Julio, for your question. First thing I would like to say is that pay TV penetration in Spain is lower compared to other European countries, so there is lot of room to grow in pay TV in Spain.

You're right, by regulation, we must make our premium content, and this includes football, available to other players. And there are some OTT players that are considering entering with different sports into the Spanish market. For instance, DAZN has acquired the rights to broadcast Moto GP, the U.K. Premier league and the basketball's Euroleague. We looked at those contents, but we were not willing to pay more than what was justified under a rational economic analysis. And given the knowledge that we have from our base of viewers, we were not willing to pay those type of prices.

In any case, if an OTT (or a pay TV telco player) wants to get access to our premium content, they need to comply with certain requirements and share the cost of the football rights according to the regulatory formula that was set by the antitrust authority when we acquired Digital Plus. This formula has 2 parts: one is a minimum guaranteed cost, and then a cost per subscriber. The minimum guaranteed cost is calculated taking into account the share of fixed broadband and the share of pay TV subscribers and sets a certain minimum cost levels. So, in the case of somebody like DAZN, if they launch their service with MotoGP and other contents, which I think they have announced they will do in the month of March, the pay TV customers that they would have by September, when they could plan to have football from us, would be counting under that formula to calculate the cost they would be paying.

Also, if at some point there was to be some coordination of commercial efforts between an OTT and some of the telco players, their shares of fixed broadband and their shares of pay TV will be added up in order to calculate the guaranteed minimum cost.

Having said this, we have seen in the past interest from OTTs that have offered even all pay TV football with limited success. Bein Connect, that was owned by Mediapro, had this type of service, and didn't manage to grow their customer base. There are as well some technical factors linked to time delays, the quality of image, some latency constraints… But again, there are very clear set rules for this content to be provided to the players that may have request it. And second, we have a healthy pay TV market in Spain with still upside in terms of penetration.

Regarding your question on Orange, every player has the right to request on a yearly basis the soccer rights from us. So, now we have Orange, we can see more players or less players asking for those contents in the seasons ahead.

Jakob Bluestone – *Credit Suisse*

I've got 2 questions as well. Firstly, just staying on Spain. Could you maybe just share with us a little bit your expectations for the sort of competitive environment in Spain? So, do you see pricing continuing to improve? I think you've already announced some price hikes for the first quarter. But just sort of more broadly, how are you seeing the competition trending?

And then secondly, obviously, a very good performance in the U.K. So again, if you could maybe just share a little bit your thoughts on the outlook for that business

Ángel Vilá – *Chief Operating Officer*

On the Spanish competitive environment, following a Q3 that had a very high level of commercial intensity, the Q4 was much cooler. The dynamics went back to normal. It was a quieter fourth quarter for us and for the whole market.

The competitive intensity softened once we removed the football-related promotions. This was followed by competitors removing their most aggressive retention promotions. We have seen significant portability slow down to minimum levels in Q4 especially around Christmas and Black Friday campaigns, when we had shorter discounts periods and softer promotional activity than in previous years.

And what we see so far in Q1 shows again a rationale market; both Vodafone and Orange kept acquisition promos, but softer than the ones offered during the summer, and Másmóvil is merely extending their promos in 2019. By segments, what we're seeing in the high-end is “M4M” moves (and remember that this is the segment that makes the most of our B2C revenues in Spain). The mid to low-end is also rational, even Másmóvil/Yoigo new portfolio launched on February 19, is showing “M4M” in some of their tariffs.

So, the market is cooler and is rational and somehow, we could say, it's polarizing. We will continue to focus on that high-value customers, which is the pillar of our business sustainability. And here, we have seen rationale and “M4M” behaviour from all players.

Regarding the U.K., it has delivered another set of very strong results, continued customer growth with 284,000 contract additions in the quarter. The total mobile base is 32.6 million, and has the sector-leading loyalty churn of 1%. So, we have seen revenue and OIBDA growth in the quarter. It's the 10th consecutive quarter of mobile service revenue growth. There are 2 very substantial metrics: Telefónica U.K. achieved this year the highest revenue in a decade and its highest ever profitability ratio. Of course, there are some factors here that are due to the business that are not going to be recurrent. For instance, the adjustment on annual license fees or some settlements we have reached with some commercial partners. But still, a very strong performance in the U.K. business, and we are confident in the outlook of the business going forward.

David Wright – *Bank of America Merrill Lynch*

If I could just add a little question on the U.K. There, you obviously have the outage in December. It clearly doesn't look to have impacted that very strong set of numbers, but I just wondered whether you are seeing in Q1 or in the last couple of months any indications of a little bit of a churn spike, whether there are any sort of financial penalties that you are going to have to accrue in 2019. If you could just give us a little bit of colour on that.

And then, I think you've mentioned sort of ongoing deleverage for 2019. I guess, given it is obviously very sensitive, very commercial, that is a comment ex-spectrum, or is that just a comment including spectrum as well. With the asset sales, should we expect deleverage to continue?

Ángel Vilá – *Chief Operating Officer*

On December 6, we lost part of our network. This was due to a software leakage from one of our suppliers who publicly acknowledged that the software provided by them was to blame and it affected other networks across the globe. We saw this as an opportunity to learn some lessons and to minimize the risk of this happening ever again. So, we took actions in order to manage the situation with our customers and this did not result in any worsening or any spike in churn. For customers in Small and Medium Business, Pay Monthly customers, and our mobile broadband customers, we credited two days of monthly airtime subscription charges. For the Pay As You Go customers, we gave a 10% credit on a top-up. Also for the Pay As You Go broadband customers, we gave a 10% discount on a Bolt On purchase. And, to the enterprise and MVNO customers, we also credited two days of airtime charges.

The overall impact of these benefits for our customers versus the commercial settlement that we reached with our supplier is broadly neutral. And what we see is that this event underscores also the importance of having a diversified supplier strategy. But, no spike in churn. Financial impact, broadly neutral and it's been already reflected in 2018 accounts.

Laura Abasolo – *Chief Financial and Control Officer*

As you know, we have a commitment on solid investment grade and we do not give any specific target on amount of net debt or ratio. Having said that, we also usually talk about FCF ex-spectrum given the confidential nature of this. But, as you've seen in our deleverage path in 2018, it has been achieved even with the spectrum. And, if you look at the deleverage path since June 2016 up to now, which has been almost €12bn, that has, of course, been achieved including the spectrum. So, when we talk of our net debt to continue reducing for 2019, that is including the spectrum that we will have to pay in 2019 as well.

David Wright – *Bank of America Merrill Lynch*

Okay, that's great. Laura, just while you're on, could I just ask a one very simple question? Is there any working capital movement of any note we should expecting for 2019 just for our modelling?

Laura Abasolo – *Chief Financial and Control Officer*

Not too different from what we've seen in the last couple of years. In 2018, as you've seen, working capital contribution has been very low, but it's been more because of non-recurrent effects from the judicial review in Brazil. You should expect a bit of contribution of working capital in 2019 as well, but not a great amount either.

José María Álvarez-Pallete – Chairman & Chief Executive Officer

If I may, I would like to complement. Laura has stated that since June 2016, we have been taking down debt, including the post-closing events, roughly €12bn. €12bn is roughly the value that we would be getting out of the transaction of the U.K. or to U.K. being sold to Hutchison and blocked by the European Commission in April. So, we have been in three years reducing basically the same amount that we were supposed to get out of that divestment, and we still have the U.K. inside which is performing extremely well, best revenues in a decade, highest profitability ever and a significant FCF generation. So, we like that consider that effort that we have been doing and that has been so far mainly organic, has been very strong and takes us to a different position. And you should expect us to keep going to the same direction.

Mandeep Singh - *Redburn*

Hi, thank you for taking the questions: I have 2 questions. So just digging into Spain a little bit. If we take out IT services and handsets, I mean IT services seems to have quite a big spike, presumably it's a lower margin contribution compared to traditional revenues, then if you take out IT services and handsets, then there's not really much sign that Spanish revenues are growing so, despite the higher inflation in football cost, that doesn't appear to be matched commercially in the other parts of the businesses. I mean is it just unaccepted that too much money was paid to those rights?

Secondly, just looking at sort of Colombia EBITDA, up 28% year-on-year, in local currency terms, U.K. up over 23%. Beyond obviously the operations being run and managed and performing very well, is there anything else that's sort of going on, any sort of accounting benefits, anything that we're not sort of seeing in the headline numbers, please?

Ángel Vilá – *Chief Operating Officer*

On your first question, we couldn't really hear very well, but if I understood right, you were saying that handsets revenues are an important element, which actually it is. For us, it's part of our strategy. We think that device relevance is critical for sustainability of the business and this is a device and handset sale which comes with positive margin. So, this is not linked to subsidies, this is not money-losing revenues, which have positive margin in OIBDA.

Service revenues, and then you were touching I think on Spain and the content costs, service revenues in Spain are back to growth. They are growing in a way that we have not seen in the previous years. This is the result of the improvement of our customer base. When you look at Fusión, we're increasing the number of Fusión customers; we're increasing the ARPU of Fusión customers; we're increasing or improving the mix of customers that have packages that include content, that include TV; and we are seeing stabilization - not worsening- stabilization quarter-on-quarter and year-on-year of the Fusión churn at the low levels that we have. Before we acquired the content costs, we had been doing lots of numbers about the economics of soccer, and we think that our strategy is showing results and is proving right.

With respect to any accounting tricks, I don't know exactly how you worded it, on the OIBDA figures in some of our operations or in any of our operations: we don’t play, and we disclose whatever elements which are not recurrent, one-offs, or whatever, so no tricks… if I understood your question right.

Mandeep Singh - *Redburn*

If I could just follow-up, sorry, I didn't mean to imply there was any accounting trickery. I just thought the performance is almost too good to be true. So, I just thought it might be some accounting changes or sort of stuff like that, but that's fine.

Ángel Vilá – *Chief Operating Officer*

No. For instance, with the U.K., I think I've been quite open and we've been transparent in the release and the presentation: annual license fees and two settlements with some commercial partners. I think I've said it 3 times in this conference call. And in Colombia, there is nothing to talk about. Thank you very much