Telefónica January-March 2020
Results Conference Call Transcript

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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 2020 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 2020 has been prepared under international financial reporting standards, as adopted by the European Union. This financial information is unaudited.

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

Presentation

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

Creating a leading communications provider in the UK

Transaction Summary

Thank you, Pablo. Good morning and welcome to Telefónica's first quarter conference call results. Today with me are Ángel Vilá, Chief Operating Officer and Laura Abasolo, Chief Finance and Control Officer. During the Q&A session we will take any questions you may have.

I would like to start today's presentation highlighting the exciting announcement we are making today that will transform the telecoms landscape in the UK. Aligned with our strategy to focus on our core operations, we have agreed with Liberty Global to combine Telefónica UK and Virgin Media UK, in a 50-50 joint venture that creates the leading integrated operator in the UK, with complementary strengths in mobile, broadband, video and B2B.

Enterprise Value of the JV is estimated at £c.38bn. The combined entity is larger, stronger and more diversified, with £11.0bn of revenues, £3.6bn of OIBDA and £1.5bn of OIBDA-CapEx (pre-synergies). On a pro-forma basis, it will have more than 46m accesses, including 33m mobile, more than 5m broadband and 4m Pay-TV.

Liberty Global will make a cash payment to Telefónica of £2.5bn to equalize ownership in the JV, and in total we expect to receive between £5.5bn and £5.8bn of proceeds from the transaction (post dividend recap).

We are again fostering in-market consolidation, convergence, combining best-in class infrastructure assets whilst unlocking significant value. We expect to deliver c.£6.25bn synergies on a net present value basis after integration costs, a c.£540m run-rate.

We are therefore creating significant value for Telefónica shareholders; the transaction is FCF accretive from year 1, and expected to reduce Telefónica's net debt by between £5.5bn and £5.8bn; Accordingly, a credit positive move that improves our competitive positioning and business sustainability, whilst reducing net debt at Telefónica.

Transaction Structure and Key Terms

Slide 3 shows the transaction structure and key terms.

Telefonica UK enterprise value has been set at £12.7bn, or 7.8 times OIBDA, and is contributed to the JV on a debt and cash free basis. Considering Virgin Media UK's EV, and after deducting its £11.3bn net debt, Liberty Global will make a cash payment to Telefónica of £2.5bn to equalize JV ownership.

The JV will target a leverage ratio of 4.0-5.0x OIBDA; we expect to raise new debt to reach this target leverage ratio and proceeds to be distributed equally between Telefónica and Liberty Global.

Following completion of the transaction, neither Telefónica nor Liberty Global will consolidate the JV.

Both companies will have equal governance rights, in line with the 50-50 shareholding, and have agreed to provide a suite of services to the JV post completion.

Stronger, larger and more sustainable player

On slide 4, we can see that will be turning into a stronger, larger and more sustainable player. The combined entity will become the largest player in the market in terms of accesses, with slightly lower revenues than the market's incumbent though at a significantly higher operating margin, benchmark for the sector in the UK. Same for (OIBDA-CapEx)/Revenues and cash conversion rates.

So, we are creating a stronger competitor with significant scale and financial strength to invest in the UK digital infrastructure and give millions of consumers, businesses and public sector customers more choice and value.

Compelling and differentiated value proposition

Among premiums brands of O_2 and Virgin Media and fully converged provided, the JV will provide more competition in the marketplace and choice for consumers, as shown on slide 5.

The value proposition will be differential as we have the following foundations;

- Customer centric proposition; industry leader in NPS and sector leading loyalty
- Fastest broadband; with broadband speeds up to 1GBps by 2021
- Rich content offering; Only UK operator offering Netflix, Amazon & all sports
- Leading technology; State-of-the art platforms and product offering
- Attractive value proposition for wholesale; wide MVNO offering ready to be a relevant wholesale player
- Complete portfolio of digital solutions; IoT with Big Data, Cybersecurity, Cloud and Advertising

National Connectivity Champion

On slide 6, with 5G rolling out across O_2's footprint and gigabit broadband soon available to all 15m Virgin Media homes, there is no question that our coming together will accelerate the UK's digital future, being the national connectivity champion.

We are going to be the unique infrastructure in Europe to seize new opportunities arising from Fixed-Mobile convergence; and there is no network monetization to date – we are retaining ownership of both mobile and fixed infrastructures, whilst being clear market leaders in UBB (including both FTTP and HFC).

Identified synergies of c.£6.25 bn NPV, with 80% of full potential related to OpEx and CapEx synergies

On slide 7, we go into detail about identified synergies.

As previously stated, as much as 80% of total identified synergies relates to OpEx and CapEx, with lower execution risk. As regards revenue synergies, we are being rather conservative, same for other financial and fiscal potential synergies which we are not even considering.

We have a proven track-record in delivering when promising. Both parties have completed several acquisitions over the last few years, systematically overachieving initial targets. Both in terms of total sizes and timings.

We expect synergies run-rate to be reached by 2026, though turning cash positive, including integration costs, as early as from 2023, with more than 75% of synergies materializing in the first 42 months.

Transaction fully consistent with TEF's strategy

Moving to slide 8, I would like to again highlight the strategic fit of this transaction within the "New Telefónica" strategy we announced last November. With the purpose of generating shareholder value, and creating relationships of trust, growth and efficiency, we needed to focus in our most important markets. And the UK is and remains a core market to us:

- This transaction creates a leading and fully integrated champion in one of our 4 core markets
- Significant value creation through synergies
- Secures superior next generation fixed infrastructure to drive customer experience, complementing T. UK's mobile network
- We will be a stronger, more valuable and sustainable platform with high dividends to continue reducing Telefónica's net debt

All in all, partnering with Virgin Media UK is the most compelling alternative for T. UK and best strategic path forward.

Governance, Exit and Timetable

Slide 9 explains governance, exit and timetable of the transaction:

On governance and shareholders agreement, The JV Board of Directors will consist of eight members, four from each of Liberty Global and Telefónica and the post of Chairman of the JV will be held for alternating 24 months periods by a Telefónica or Liberty Global appointed director.

On exit, there are some windows after the 3rd anniversary and after fifth.

And finally, on timetable, closing will be expected for Q4 2020, 2021 or Q1 22 the latest, after approval of the second phase, European Commission (EC) and Competition and Markets Authority (CMA).

Closing Remarks

To conclude on today's announcement, and before moving on to rapidly review first quarters' results and current environment, I would like to stress that we remain committed to our strategy. No matter current uncertain times, it is the long-term sustainability that drives our decisions. We believe this this the best and the only way to unlock value.

- We are creating a leading integrated player with significant cross-selling opportunities in the second largest European market, improving our market positioning, the group's profile and business sustainability

- We are combining Telefonica UK's leading mobile operations and Virgin Media UK's extensive superfast broadband network to benefit consumers, businesses and the public sector through investment to accelerate digital infrastructure deployment and improving customer experience
- Whilst doing so, we create significant value: total OpEx, CapEx and revenue synergies with an estimated NPV of c.£6.25bn (after integration costs), with potential additional financial / fiscal synergies not being considered
- Creating substantial value creation for Telefónica's shareholders

Today we are changing the UK telecoms market landscape, one of our core markets. We are as well fostering in-market consolidation in Brazil, all aimed at granting a more predictable future to our shareholders.

COVID 19 implications Q1 20 highlights

Telecoms proving essential; responding all stakeholders

Moving now to slide 11, it is worth highlighting our mission, "to make the world more human by connecting lives", has turned even more evident than ever during this crisis. Connectivity has proven even more critical, and thanks to the focus and investment in our infrastructure over the last years (over €90bn since 2012), we have been able to guarantee continuity of service. And this service has been key to society being able to state connected and mitigate the impact of the crisis.

Our networks have proven resilient, reliable and stable, managing traffic peaks, with as an example, in Spain, the company has been able to cope with an increase in bandwidth demand of almost 40%, a growth of mobile data traffic of 50% and mobile voice of 25% in the first weeks of the confinement by COVID-19.

This has enabled us to be in a position to use our capabilities to support public administrations and health institutions. We have at the same time secured the integrity of our operations, helping to maintain the supply chain.

The COVID-19 outbreak has also demonstrated that our business model is sustainable, and we are now more confident on its resilience. A resilient model built on digital transformation over recent years, enable us to cope with increased demand for connectivity and remote working solution whilst also working with public bodies to keep society connected.

We have responded to our stakeholders' needs, in a responsible manner. We needed to care about our employees and we promoted working from home for as much as 95% of our workforce. For our vendors, we have shortened payment terms whilst trying to help them with some of their liquidity issues.

We cared as well about our customers, showing flexibility with payments whilst increasing data allowances, and offering faster speeds and richer content offerings. And above all, we needed to respond to our society needs, making all our services and capabilities available to institutions.

We feel that through these responses we have as well taken care of our shareholders, showing responsibility.

Doing well; not immune, but relatively well protected

On slide 12 we go through a revision of potential COVID-19 impacts. Let me start by saying that this is uncharted territory. Extension of lockdowns, pace on lifting of restrictions, and economic impacts in each of the countries in which we operate are still to be seen.

In any case, the resilient business model I referred to in the previous slides makes us not immune, but much better protected than others.

Of course, we will face negative revenue impacts; overall commercial activity has been stopped, and both consumer and corporate customers are to suffer in one form or another. But whilst in the short-term we may see lower roaming, reduced prepaid recharges, or SME customers navigating through difficult times, long-term prospects remain, if any, intact. Demand for connectivity is on the rise, need for speeding-up digitalisation in the corporate world has proven real, and changes we see in consumer habits are here to stay.

But even in the short-term we have levers to weather this storm. Yes, our top-line will be negatively affected, as mentioned (though to a lesser extent than for many other industries). This will nevertheless be more muted at the OIBDA level, as lockdowns as well bring down churn and overall commercial expenses. Not to mention prepaid, B2B revenues or handset sales have lower than average margin.

We count with additional levers in the form of discretionary investment, despite we remain focused on our growth opportunities. All in, we have enough tools to preserve FCF, which allows us to be better prepared for future opportunities. Moreover, delays in spectrum auctions will occur, like Spain, UK and Brazil.

2022 Guidance and 2020 €0.4/sh. Dividend reiterated

Moving to the next slide, we reiterate our 2022 guidance and 2020 dividend of €0.4 per share.

Due to the significant changes in the guidance scenario and context and the current level of uncertainty 2020 financial guidance is withdrawn. Nevertheless, we will closely monitor the evolution of our businesses and will manage CapEx and OpEx accordingly to focus on OIBDA-CapEx stability. In the current context, the outlook for 2020 OIBDA-CapEx is to be slightly negative to flat y-o-y. As for the mid-term, 2022 guidance of Revenue growth and 2 p.p. improvement in (OIBDA-CapEx)/Revenues is reiterated. To note that this crisis has accelerated the digitalisation processes in all processes, increasing our relevance significantly.

Confidence in our business model flexibility to weather current environment, coupled with a solid liquidity position and business resiliency, allow us to confirm the announced €0.40 dividend for 2020. The payment of the second tranche of 2019 dividend (€0.2/share) to be paid in June and the first tranche of 2020 (0.2€/share) to be paid in December will be voluntary scrip giving more flexibility to both our financial position and our shareholders in this unprecedented situation.

I now hand over to Ángel to go through a detailed review of the business units performance.

Ángel Vilá – *Chief Operating Officer*

Financial summary

Thank you, José María.

Turning to slide number 14, let me summarise our main financials.

Reported figures for the first quarter reflected the negative evolution of forex. Revenues topped almost €11.4bn, declining 5.1% y-o-y on a reported basis and just 1.3% in organic terms and grew 0.1% in the core 4 markets, Spain, UK, Germany and Brazil. It is worth highlighting the continued transformation of our top line, especially in the context of this COVID-19 crisis, with 65% of our services revenues already coming from broadband and services over connectivity, 2 p.p. more than a year ago.

OIBDA reached €3.8bn, and though reported annual evolution is impacted by forex and capital gains registered in Q1 19, in organic terms it shows a drop of 1.7%, which turns into as much as 1% annual growth if we look at our four core markets.

Leading profitability is maintained in organic basis, with OIBDA margin flat vs. January-March 2019 to stand at 33.1%, and (OIBDA-CapEx)/Revenues reaching 20%, just 0.5 p.p. lower organically, but increasing 0.7 p.p. in the four core markets.

Net income reached €406m and Earnings per Share stood at €0.06 per share, or €0.11 in underlying terms.

FCF is impacted by the usual first quarter seasonality, whilst the comparison base for same period last year is distorted by the tax refund received in Spain.

Finally, net financial debt stood at €38.2bn, declining 5% y-o-y, and reflected the punctual increase in Q1 due to the exercise of the outstanding hybrid first call date in March 2020 and the hybrid issued out of Colombia.

Regarding COVID-19 impacts, those were -€77m in Revenues, -33m in OIBDA and -€17m in CapEx in Q1, approximately the last 15 days of March, and we see risks and opportunities going forward.

Spain | The most reliable and advanced telco in Europe

On slide 15 we review our Spanish operation. After strong investment efforts in past years owning the largest and most powerful FTTH network in Europe, has proven critical during the quarter to support stable and reliable connectivity to our customers and to the overall society.

Our network delivered at a time when both our retail and wholesale customers required an additional effort from us. Despite lockdown having an impact on our commercial activity, we stood by our clients through our online channels; and we responded to our consumer and corporate customers needs providing free extra data and enriching our content and digital services offering.

Being the most reliable and advanced platforms allows us to have the most valuable customer base, mostly in high-end services, video and UBB fibre, and seating mostly in convergent bundles. Despite not having lock-in clauses, churn improved in Q1 showing how resilient our business stands within this environment.

So far, impacts from COVID-19 have been limited, but noticeable already in the month of March. Revenues showed a slight decline, mainly concentrated on the retail segment, but efficiency gains led OIBDA-CapEx to increase by 1.4% y-o-y. Cash generation is our focus, and we will prioritize OpEx and CapEx to continue delivering benchmark cash conversion in the coming months.

Germany | Robust start to year

Moving to slide 16.

After COVID-19 environment started, Telefónica Deutschland has supported employees, customers and the wider society through a variety of initiatives such as offering complementary app access for a limited time period and launching a series of live-streamed O_2 concerts. The network is coping well with the new traffic patterns and the company maintained a clear focus on improving customer experience also underpinned by strong network resilience.

Despite this tough environment, Telefónica Deutschland delivered a robust start to the year, maintaining its profitable momentum across all revenue lines despite softer trading trends following the government imposed lockdown.

The Company posted a strong 3.8% y-o-y revenue growth, OIBDA turned positive and improved by 1.5% y-o-y. As such, OIBDA-CapEx increased by 12.9% y-o-y in January to March.

UK | Once again outperforming the market

Moving to slide 17, where we review the performance of our UK business.

In the COVID-19 environment Telefónica UK has played a key role in keeping the UK's customers, businesses and public services connected. Our response has included doubling our network capacity, helping our customers and strongly supporting the National Health Service.

In Q1 we have seen limited COVID-19 related impacts due to the later timing of lockdown.

Within this environment, Telefónica UK posted the 15th consecutive quarter revenue growth y-o-y with a sector leading contract churn at 1.0%, confirming its market leading position in a highly competitive market, while growing mobile customer base by 6% y-o-y. Worth highlighting in the quarter is the exclusive launch of Disney+.

The Company continues to outperform the market and posted +1.5% y-o-y revenue growth, OIBDA improved by 1.1% y-o-y and OIBDA margin stood at 29.7%, stable y-o-y. Thus, (OIBDA-CapEx)/Revenues ratio improved by 3.7 p.p. q-o-q in January to March.

Brazil | Predictable & resilient FCF generation

We now move to slide 18 where we review the performance of our Brazilian operations.

In this economic and social context, Telefónica Brazil plays a relevant role as an enabler of connectivity to its customers. In this respect, and along with other measures, we have decided to offer higher data allowances across our plans for no additional cost, and to open more than 100 TV channels for all customers.

During Q1, Vivo maintained its leadership in the mobile business with a 33% market share and a remarkable 39% market share in the contract segment. In the fixed business, it is worth mentioning the new alternative fibre expansion models, such as the agreement with ATC or the Franchise model, that allow the company to boost connections and reach almost 2.7m accesses connected with fibre to the home at the end of March.

Operating wise, and for another quarter, the Company posted very solid OIBDA and OIBDA-CapEx growth.

Despite initial impacts from COVID-19 mainly in prepaid and in handset sales, the ongoing transformation of the Company towards fibre, the continued migration to contract and the steady digitalisation process we have been undertaking for the last few years, allow the company to be confident on the continued FCF generation going forward.

Telxius | Growth and margin; continuing tower expansion

On slide 19 we can see how Telxius' growth and margin increased along with its continued tower expansion.

In the first quarter of the year, Telxius acquired 1,927 towers in Brazil and Peru, that combined with new towers built, grew its towers portfolio by 21% y-o-y. Moreover, Telxius has doubled its size in a relevant market such as Brazil, consolidating itself as an industry leader with a total portfolio of over 20k towers in March, with a tenancy ratio of 1.34x (or 1.36x ex-acquisitions).

Revenues and OIBDA grew by 6% and 12% y-o-y organic respectively, excluding the exceptional subsea cable capacity sale of the first quarter 2019. This acceleration in the quarter drove OIBDA-CapEx growth up to 11% y-o-y excluding the new Pacific cable construction.

Now, I hand over to Laura.

Laura Abasolo – *Chief Financial and Control Officer*

Hispam | Working on transformation; increasing efficiencies

Thank you Ángel. Moving to slide 20,

Telefónica Hispam, like for the rest of our units, has taken initiatives to offer specials benefits to clients in order to improve and expand connectivity, such as free browsing through certain applications or higher data allowances across mobile plans.

In the region, the Telecom sector appears initially more exposed to COVID-19 potential impacts due to mobile prepaid exposure. However, the on-going digital transformation, the continuous migration to high value accesses and achieved CapEx efficiencies make us feel confident about the resiliency and strength of our business.

Revenues and OIBDA y-o-y trend continued to be highly affected by tough competitive situation in Peru and Chile. On the other side, it is worth highlighting that the more suitable model just implemented in Mexico is already showing positive results, with OIBDA y-o-y growth in Q1 for the first time in 9 quarters.

Currency headwinds structurally neutralised

Moving to slide 21, we look in detail at how FX impacts our first quarter results, again proving currency headwinds are structurally neutralized. Even more, we actively hedged cash flows of Brazil and UK.

FX dragged 3.2 p.p. in Revenues and 3.5 p.p. in OIBDA's y-o-y variation, with the Brazilian real the currency that most depreciated against the euro. Nevertheless, the negative effect of €151m in OIBDA level translated into just €20m in FCF terms.

As regards to net debt, in the 12 months rolling period to March 2020, FX had a positive impact of €824m.

Slight debt increase on hybrids amortization

As anticipated in 2019 full year results, net debt in March has slightly increased by nearly €500m, mainly explained by the amortization of a couple of hybrids references with non-call dates in March 2020. Other than this temporary effect of €700m, net debt would have continued downward trend shown in previous quarters.

FCF generation in the quarter amounts to €233m and it is expected to improve for the remaining of the year.

Strong liquidity position coupled with smooth maturity profile

Slide 23 shows Telefónica's strong liquidity cushion, amounting to €22.5bn, covering well in excess of next two years debt maturities, without considering cash generation, additional financing nor credit lines extensions. It is to note the high quality of Telefónica undrawn credit lines, mainly with maturities of two years or beyond and no MAC clauses.

Additionally, it is to highlight, our proactive and extensive financing activity undertaken in the last years, nearly €39bn funds raised in total since June 2016 to date. During this quarter we have continued with this activity issuing €2.3bn of new debt benefiting from minimum costs, including a €1bn 10y Bond and the first Green Hybrid issued in the Telecom sector (of €500m), with respective coupons of 0.66% and 2.50%.

We have approached different pockets of liquidity, extended our average debt life from 5.6 years to 10.7 years, while achieving the lowest coupons ever in recent deals.

As a result, our effective interest payments cost has been reduced to 3.49% in March 2020, 109 bps lower than in June 2016.

In summary, we have been successfully strengthening our balance sheet in the last years.

I will now hand back to Jose María to recap.

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

Conclusion | Sustainable; Long term focus

Thank you, Laura.

To conclude, in this environment of coronavirus pandemic, the telecom sector is proving essential, and our mission, which is "to make the world more human by connecting lives", has turned more critical than ever. We are one of the most protected and resilient sectors, and inside the sector, Telefónica continues showing its strength remaining ahead of the curve in crucial aspects such as state of the art infrastructure and network modernisation. We have as well a solid liquidity position, result of the prudent and strict financial discipline we have followed over the last few years.

We are obviously not immune to the current crisis. But our sustainable model, built via being committed to our strategy and our values, has allowed us to respond to our stakeholders needs (both employees, customers, suppliers and the society in general).

We will continue to progress in this sustainable model on its 3 fronts: growth, efficiency and trust. By doing so, we believe we will continue to deliver long-term value creation for our all our stakeholders.

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

Q&A Session

Jakob Bluestone – *Credit Suisse*

Firstly, can you maybe elaborate a little bit on the thinking behind the dividend, keeping it at €0.4, you've obviously gone to voluntary scrip. But just sort of in terms of thinking, why didn't you go for full scrip or sort of create a little bit more flexibility? Is that sort of a reflection of your confidence that you can sustain your equity FCF generation? Is that sort of how we should read that? So, if you can just help us on process a little bit in that?

Secondly, on Spain, you reported, I think it was a 3% decline in your retail revenues. Can you maybe give us a little bit more sort of colour on what's going on in that? It looks like, particularly the sort of decline came through in the non-convergent revenues and certain sort of clarity or additional detail you could give on what's going on with that part of your revenues would be helpful.

And then finally, on the UK transaction. I guess one of the big parts of the synergies is getting the Virgin MVNO back to your network. Are there any sort of costs associated with that?

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

Taking your first question on the dividend. As you might imagine, we have analysed all scenarios, considering also the low level of visibility that anybody has on what might happen in the macroeconomic scenario. What we know for sure, as we were detailing on the presentation, is that we are not immune, but we are more resilient than others. And the impact that we are having in revenues, we have levers to neutralize part of that at the level of OIBDA through the manageable OpEx that we have. And additionally, further down the road, in terms of CapEx, trying not to compromise the strength of the networks that we have built. And therefore, considering all circumstances, we think that in terms of FCF, and also considering that some of the spectrum auctions are likely to be delayed, FCF generation enable us to have a very good coverage of the dividend. But in order to preserve more financial flexibility, we have decided to include the optionality of our scrip dividend, a voluntary scrip dividend. And therefore, depending on what's the percentage of shareholders that might come, we might build up additional financial flexibility. So, we think this is the more prudent approach and, at the same time, preserving an attractive dividend policy and showing the confidence that we have on the FCF generation of the company, in spite of current circumstances.

Ángel Vilá – *Chief Operating Officer*

Regarding the question on the evolution of Spanish revenues. In the first quarter, total revenues declined 1.6% y-o-y, reflecting certain COVID-19 related impacts, in particular handset sales. Service revenues declined 1.2% y-o-y, less than total revenues, mostly due to non-convergent revenues, not offset by the growth in IT and wholesale. So, if we look at retail, to your question, -3.4% y-o-y, this is due to this lower non-convergent communication services, non-convergent communication revenues, despite the IT growth. The convergent and new services show a minor decrease, mostly in line with the convergent ARPU decline. So, the evolution of this line is linked to the non-convergent communication revenues. At the same time, wholesale and other revenues have increased 10.8%, very positively impacted by NEBA and TV, and despite the ULL decline.

The third question on UK transaction synergies; we have identified synergies with a net present value of £6.25bn. You can see that on Slide 7. Of this level of synergies, 65% are to be coming from OpEx; 15% from CapEx; so 80% of the total synergies are OpEx and CapEx related, and only 20% are related to revenue. If one does the ratio of these synergies over the combined cost and CapEx base of the entities combined, you will see that it stands slightly above 4% of those, which compares very favourably to previous transactions being presented to the market, in which the median of that ratio is between 5.5% and 6%. So, these are synergies, which we believe are achievable and which compare well with the benchmarks of other transactions. Among the OpEx synergies, we include the migration of the Virgin Media mobile traffic to Telefónica's UK network. It's the largest component in this OpEx bar of synergies, but I cannot disclose further details.

Michael Bishop – *Goldman Sachs*

Firstly, on the relative valuation of O_2 and Virgin Media, could you just give us a little bit more colour on the discussions there? Because clearly, it's a very complex job valuing the two companies. And especially, I was thinking about things like your stake in CTIL, potential tax losses at Virgin Media and really, what did the discussions centered around and ended up at the two relative valuations?

And my second question is, you've highlighted the impact of hedging, mitigating a lot of the negative FX headwinds at FCF level. And if I'm right, it looks like the offset, at least in the first quarter from hedging was quite a lot more than the impact that you disclosed through 2019. So, could you just, perhaps, give us a little bit more information on how your hedging strategy has changed or evolved to drive that better offset as you face the FX headwinds? Thank you very much.

Ángel Vilá – *Chief Operating Officer*

Thank you, Michael. I'll take the first question on the relative valuation. We have brought to this merger the perimeter of Telefónica UK, including the 50% stake in CTIL. At the same time, Virgin Media is contributing the asset in the UK including the projects that they have on fixed ultra-broadband, Project Lightning, but excluding the Irish business. When approaching the relative valuations that led to the equalization payment, given the leverage that each one of the assets is bringing, we have been focusing on the two fundamental valuations.

First, on discounted cash flows of each one of the businesses, and we have also been taking into account the valuation of precedent transactions. Clearly, a third traditional metric that you have in this situation, which is market multiples comparable, is not a proper reference given the situations that we are navigating through in the markets. So, if one looks at DCF valuations for each one of the assets, the values agreed for the transaction and the multiples agreed for the transaction sit squarely in the middle, or close to the middle, of the DCFs range for each one of the two assets. But also, if one looks at the transaction precedents, and there have been quite a few precedent transactions of fixed mobile convergence across Europe, you will see that those multiples are also consistent with those ranges.

Laura Abasolo - *Chief Financial and Control Officer*

If I may continue on the FCF hedging one. I think the numbers this quarter show the hedge we have throughout the FCF and net income that we have been discussing for many quarters. This quarter, the Brazilian real and other Latam currencies have been affecting a lot. And in the case of Brazil, as you know, we have minorities, we have a higher CapEx over revenues than the remaining of the portfolio, and all that makes that we don't only have revenue affected but also other cash outflows. And the resulting is that FCF final impact has got minimized.

The pound, on the other way, this quarter on average has appreciated. So, I think it has to do with the mix, and this particular quarter, shows how the final impact of the FX coming from Latam currencies can get minimized as we go down the FCF line. This is not affecting the figure this whole Q1, but it is true that this year, on top of that, given the volatility we were forecasting both for the real and the pound, and the difficulty to preview or forecast the FX, we did some hedging on the FCF that will come throughout the year. But that's a different hedging that we have done in order to have more predictable FCF coming from those geographies; but it's not the explanation for the Q1 that was your specific question: it has to do with the mix of the currencies.

David Wright – *Bank of America Merrill Lynch*

Thank you very much for taking the questions and congratulations on the deal. My question is around Project Lightning that Virgin Media has injected. There has been a lot of commentary from management at Liberty that they could look to even spin that asset out with an infrastructure investor, or that they could look to accelerate build and even provide wholesale services. What is the strategy for Project Lightning in the JV, please?

Ángel Vilá – *Chief Operating Officer*

We, as you know, have been proponents and believers of ultrabroadband, in particular, fixed. The Spanish marketis the most developed in terms of fibre across Europe. So, we looked at this deal, Project Lightning, as one of the attractions of the project. At the same time, Liberty Global valued significantly the experience that Telefónica has in the industrialisation of the fibre process, which has led us to achieve one of the most efficient ratios of speed and cost in deployment of fiber, also combined with the standardisation of all the equipment around the fibre system.

The project Lightning, as it's progressing, at the end of 2019 had 1.9m homes passed. There is a plan, which was already in the market by Virgin Media, to more than double that by 2024. The ultrabroadband infrastructure of Virgin Media, at this stage, is covering 15m of homes passed in the U.K. with speeds at around 500Mbps, but ready to upgrade to Docsis3.1 to get to 1 Gbps, but also in new areas is through deployment of fibre.

For us, this is the way going forward, and we are supportive, obviously, of this project. And if conditions allow, we would support the JV to progress more decisively across this. This deployment also is being done through owned ducts, which provides sustainability to the whole deployment. So, Project Lightning is part of the project. Strategic alternative regarding Project Lightning, how to structure or restructure it to make it even more ambitious, will be, in due course, discussed by the partners. We are open-minded on this. So, we are open to explore alternatives to use in the smartest way the infrastructure that both partners are bringing to the table, being Lightning or being CTIL.

David Wright – *Bank of America Merrill Lynch*

I see. And just to follow-up, please, Ángel, are there any, within the synergies, within the current business plan, are there any plans to wholesale at all the fixed line network, whether that be existing cable infrastructure or Lightning further?

Ángel Vilá – *Chief Operating Officer*

That will be something to agree between the partners once the JV is in place, post completion.

David Wright – *Bank of America Merrill Lynch*

I see. Okay. But it's not in any synergies or business plan right now, no wholesale? It's a huge variable, I think, on this particular deal that Liberty's talked about a lot, but really wasn't commented at all in the releases.

Ángel Vilá – *Chief Operating Officer*

It's not included in the synergies.

Joshua Mills – *Exane BNP Paribas*

Just the first with regards to the cash inflow on year 1 of this transaction. So, you're guiding for about £3bn worth of dividend upstream. I'd just like to know where that leaves the JV in terms of leverage. My assumption would be that's probably towards the higher end of the 4-5x range. So just if you confirm that, would be great.

And then secondly, would be great if you could give us a bit of insight into the Spanish operating trends. You mentioned COVID-19 is clearly having an impact, but perhaps if you could give us an update on how your customer mix has shifted between Fusión, O_2, high and mid, low-end bands that you often do, would be very helpful?

Laura Abasolo - *Chief Financial and Control Officer*

O_2 UK is going to be contributed to the JV debt-free, and Liberty will be contributed to the JV with about £11.3bn of leverage. And, on top of that, we are estimating a recap of approximately £6bn that will lead to the high end of the range, although it will obviously depend on the final figures by year-end and at the time of closing.

Ángel Vilá – *Chief Operating Officer*

Regarding your question on the operating trends in Spain. First, on the quarterly trading, net adds have shown a slight decrease on lower gross adds, impacted by tough commercial dynamics that took place in January, February, and the lockdown in March not allowing for recovery for a weak first half of the quarter. At the same time, fixed broadband net adds improved, both q-o-q and y-o-y. The fibre base is reaching 6.7m subscribers, 4.4 retail, 2.3 wholesale, which is 16% up. And we have been recovering in churn, even before the lockdown in mid-March. So, even before that, we were back to usual figures, around 1.5% and despite the end of promos and More for More.

The ARPU, reaches €91.8. This is the ARPU of convergent products, plus SME convergent products and digital services related to convergent customers, and is 1.1% down. This was due to consumer upselling, a positive, higher ratio of additional mobile lines, minus dilutive effect from multi-brand options, mainly driven from the higher weight in the mix of O_2, and lower extra consumption outside the bundle.

We are no longer disclosing the guide of the value mix in the ARPU because we think that that's commercially sensitive and could also, given the different price points of the different segments of what we used to define as high, medium and low, was becoming misleading in the interpretation of the information. We continue to have average ARPUs which are significantly higher than our next competitor and the average of the industry, but also because of our customers have more services in their bundle.

Mathieu Robilliard – *Barclays*

First, coming back at the dividend question maybe from a different angle. I see that one of the rating agencies has put your rating to a negative outlook, and I was wondering how has you prioritized your current credit rating versus the cash remuneration to shareholders, is one more important than the other? Or can you manage both at this stage?

And then, with regards to Latin America and M&A activity there. It seems that in Brazil things are progressing well despite the current crisis. On the other hand, with the Costa Rica deal not being finalized. I don't know how much color you can give in terms of other initiatives and maybe the impact of current prices on your plans to spin-off there?

Laura Abasolo – *Chief Financial and Control Officer*

Let me take the dividend and the link to the credit rating. I think that what we have done with this decision is a balanced approach. It's showing prudence, it's showing the liquidity and credit rating quality is important and fortunately, we are strong in both terms, but it is also showing commitment to shareholder remuneration. We have done the homework to sustain an attractive dividend policy, but we are also looking for flexibility. And we are giving flexibility to our shareholders because we are giving the option to have dividend in cash, which is important to some of our shareholders, and it also shows consistency, and we're also preserving free cash flow for the other shareholders that are fine also with that decision and taking more shares of Telefónica. It's not one goal versus the other. We want to create value to our shareholders, and we want to be within a solid investment grade rating. And I think that this proposal is a hybrid solution, it's a balanced approach, it shows resilience from a shareholder perspective, but goes also in the right direction for keeping and protecting our solid investment grade. So, it's a balanced equation.

If I may on the Hispam question. We continue working at full speed in the operational carve out, and we have done lots of things. You have seen some movements from some of our shareholdings to a vehicle throughout the first quarter of the year, end of March, for instance, in Peru and in Colombia and other OBs. We are also working in preparing ourselves for a potential financial spin off, but there are also alternatives open from an M&A perspective. So we are doing all the homework at full speed, remotely, as everything else in the new Telefónica at the moment.

On the financing market, it's true that the situation today is not ideal. We would have not been ready for a financial spin off in any case today. So, there are still months to come and months of pending work. Hopefully, the situation will be calmer, and we will be able to approach the market in due term.

Georgios Ierodiaconou – *Citi*

I have two. One is around Cornerstone, and I believe Ángel, you alluded to this when you were discussing options around the fixed line. I'm curious about the process for the tower sale at Cornerstone, whether that is impacted at all, whether you will wait until the transaction is completed, or whether there could be a parallel disposal of towers of Cornerstone?

My second question is around other initiatives to monetize your infrastructure. Is it possible to update us where are we with some of these initiatives, and there were some articles around the German situation a couple of week ago; any delays or any fiscal or other hurdles that may either delay or cancel some of these initiatives?

Ángel Vilá – *Chief Operating Officer*

Thank you, Georgios.

Regarding Cornerstone CTIL, we have been preparing the asset, all the model, operational model and financial model, for what would be a market-oriented tower company. This phase of preparation is basically complete.

Now the transaction to create the UK JV has meant two things. First, that 50% of CTIL is part of the assets contributed into the perimeter of the JV transaction. So, the asset will be held by the JV. And second, the two options that you were talking about are possible: monetisation could take place once the JV deal completion has finished, or it could be approached in-between signing and closing, of course, if the different parties that have interest in this situation, wanted or agreed in going ahead with such a potential monetisation. So, it's possible, it's not that it cannot take place before completing the JV deal, but we would need to talk with the different parties involved now in the situation. The asset is ready for such possibility.

Regarding other initiatives to monetize infrastructure, we have been very active with tower deals, so far in the year. Some tower deals have been incorporated to Telxius, as I was saying in my presentation. So, 2k towers, in rough numbers, from Brazil and Peru have been contributed into Telxius. We have also sold outside of the Group and monetized towers in other Latin American geographies, Colombia and Ecuador in particularly, which were of less interest to Telxius, and we sold them out of the Group.

We are very advanced in a potential tower deal in Germany, as was expressed by my colleagues of Telefónica Deutschland yesterday in the conference call. This would be a substantial number of towers. Our preferred route is to contribute those to Telxius, with our partners in Telxius contributing cash to maintain their percentage in the company. And therefore, we are achieving effective monetisation as we transfer those towers to Telxius. The deal is advanced. It's still pending some elements of the negotiation. As soon as there would a deal be achieved, of course, we would communicate it accordingly to the market.

Charlotte Perfect – *Arete*

Really my question is around the Spanish trends as asked earlier. But if I may just follow-up on that, on my understanding you don't want to give the split into premium, mid and low tier of your convergent base. But I'm just wondering, what's your outlook? As we go into a recession, and over the next 6 months, and as consumers become a bit more price-sensitive, are you expecting further downspin in the market? I guess, also as the Virgin plan rolls out and MasMóvil continues its advance as well. And so just really, I would like to understand your outlook on downspin in Spain?

Ángel Vilá – *Chief Operating Officer*

Regarding the outlook for Spain: pre-COVID-19, we were targeting OIBDA-CapEx growth on a trend of growing key accesses, launching new services and with a positive outlook, which is still there, for wholesale revenues. Also, at the OIBDA level, copper decommissioning and digitalization were to keep providing benefits, on top of improved trends in costs, in content and personnel, and of course, having stable CapEx.

Now what we see is that uncertainty is maybe the main attribute for the year. So, we foresee pressure on the top line. In any case, and given this pressure on the top line, we cannot longer aim for a stable top line and OIBDA, but we have room. We have room for acting on OpEx and CapEx and aim to preserve operating cash-flow.

At the OIBDA level, part of the loss in revenues will be compensated by OpEx savings, in supplies and in commercial costs, and efficiencies that were already up and running. So, this should allow us to maintain OIBDA margins at around 40%. And then, when we translate this into OIBDA-CapEx, given our flexible CapEx model, we are aiming for the Spanish operation for slightly negative to flat operating cash-flow.

Pablo Eguirón – *Global Director of Investor Relations*

With this we will finish. I'll hand over to José Maria to close the call.

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

Thank you very much for your participation. We certainly hope that we have provided some useful insights for you. Should you still have further questions, we kindly ask you to contact our Investor Relations department. Good morning and thank you very much.