

Telefónica January-December 2020 Results Conference Call Transcript

25th February 2020

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Introduction

Pablo Eguirón – *Global Director of Investor Relations*

Good morning, and welcome to Telefónica's conference call to discuss January-December 2020 results. I am Pablo Eguirón, Global Director of Investor Relations.

Before proceeding, let me mention that the financial information contained in this document related to the fourth quarter and full-year 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.

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

Presentation

2020 Highlights

1. Material progress against strategic objectives

Thank you, Pablo. Good morning and welcome to Telefónica's fourth quarter and full year results conference call. With me today is Ángel Vilá, Chief Operating Officer, and Laura Abasolo, our Chief Financial and Control Officer. As usual, we will first walk you through the slides and then we will be happy to take any questions.

I would like to start by highlighting the material progress against strategic objectives made along during the year.

First, across our four core markets, Spain, Germany, UK and Brazil, we have improved our value proposition, increasing our premises passed with fibre to more than 25 million in Spain and 15 million in Brazil. In the UK, the combination of O2 and Virgin Media is progressing to plan, whilst in Brazil our joint bid won the auction for Oi mobile, which will further strengthen our market position when completed.

The legal separation of Hispam was successfully completed in the year. In parallel we continued to optimise efficiencies, increasing profitability and reducing our equity exposure. In addition, we have announced the launch of an independent and neutral fibre network vehicle in Chile.

In T. Tech, carve-outs are almost completed and fully functional. In the meantime, we continued to develop our digital capabilities and build our IoT and Big Data portfolio, aimed at a range of vertical B2B markets and new Cloud solutions in Edge computing.

We progressed as well at T. Infra, where we continued to realise value. The sale of the Telxius towers to ATC for €7.7bn implied a record multiple of 30.5x proforma OIBDAaL and will reduce net financial debt by €4.6bn. Additionally, we are in advanced negotiations with a major international financial investor for the construction

and offer of a neutral, independent fibre wholesale network in Brazil and recently signed a partnership with Allianz for FTTH rollout in Germany.

Finally, we continued to simplify our operating model, with 79% of processes being already digitalised, up 10 percentage points against last year. We also signed a MoU with leading European telcos to promote Open RAN with successful technical testing in the UK and Germany during Q4.

2. 2020 performance highlights

Moving to slide 2 and our 2020 performance:

We saw good momentum in the last quarter, with organic revenue and OIBDA trends accelerating across all segments.

Customer engagement improved, with NPS in our four core markets increasing 7 percentage points versus last year, and churn declining for the 4th consecutive quarter.

Group OIBDA-CapEx returned to organic growth at +1.9% year-on-year with margin improving by 0.7 percentage points.

This reflected incremental cost efficiencies and digitalisation, that accelerated with digital sales growing 12 percentage points versus last year to reach 31% of total sales. As a result, organic OpEx was down 2.2% year-on-year in Q4 20.

Of particular note is the 2020 Earnings per Share, which stood at 0.24 euros and grew 54.3% year-on-year.

As a result of prioritised investments in Next Generation Networks, we now reach 135 million premises passed with ultrafast broadband.

Free Cash Flow improved remarkably throughout the year.

We therefore continued to deleverage, reducing net financial debt by 2.5 billion euros to 35.2bn at year end. This will decrease further by the additional 9 billion euros derived from our recently announced inorganic transactions, an amount equivalent to 25% of our year end net financial debt.

3. Robust financial performance in a challenging year

Slide 3 shows our robust financial performance in a challenging year.

In 2020, reported revenue declined 11% year-on-year, largely attributable to unfavourable Forex trends, which accounted for 6.5 percentage points of the decline, changes in the perimeter and others.

OIBDA declined 10.7% year on year on a reported basis, or 5.7% organically, excluding negative Forex effects as well as changes to the perimeters and others.

Free Cash Flow per share increased to 0.37 euros in Q4, reaching 0.88 euros per share in 2020.

Worth highlighting is that free cash flow generated in the last 5 years amounts to 25 billion Euros, with 2020 FCF being in line with the last 5 years' average despite the challenges. This cash flow stability, has been a major driver in bringing down our net debt by 17 billion euros since June 2016.

4. Financial summary

Our reported results, summarised on slide 4, reflect the significant impact of COVID-19, which caused a decline in revenues and OIBDA of 1.9 and 1 billion euros respectively in 2020. It also reflects Forex headwinds, which reduced revenues and OIBDA by 3.1 and 1.2 billion euros respectively.

Revenues reached 10.9 billion euros in Q4, declining 2.0% year-on-year in organic terms, while OIBDA stood at 3.7 billion euros, down 2.8% year-on-year in organic terms. We saw improving trends in our core markets throughout the year, with both revenue and OIBDA declines narrowing.

OIBDA less Capex over revenues increased by 0.7 percentage points versus the same quarter last year in organic terms, again showing increased operating leverage and capex savings, despite continued investments in high-priority areas.

Underlying Net income reached 1 billion euros in Q4, growing 4.9% in 2020, and surpassing the 3 billion euro mark.

We delivered outstanding growth in Free Cash flow in the fourth quarter, which increased by double digits to almost 2 billion euros, lifting full year Free Cash Flow to almost 5 billion euros.

Net financial debt continued to decline, reducing by 6.7% versus December 2019 to 35.2 billion euros.

5. Accelerated recovery in Q4 20

Turning to slide 5, Q4 20 year-on-year trends accelerated versus the previous quarter, with improvements seen in both revenues and OIBDA across all segments of the business.

The revenue decline narrowed by 2.2 percentage points versus Q3 while the OIBDA decline narrowed by 5.4 percentage points.

In addition, we maintained our long track record of efficiency gains, further increasing our organic OIBDA minus Capex margin by a fifth consecutive year year-on-year, to 20.4% at the end of 2020.

6. 2020 financial outlook delivered

Slide 6 shows we delivered against our full year guidance of slightly negative to flat organic OIBDA-CapEx, thanks to effective operational management to preserve cash.

We are also confirming today the final dividend for the year of 0.4 euros per share. The first tranche of 0.2 euros per share was paid in December through a scrip dividend, with 67% of shareholders opting to receive new shares, further enhancing our financial flexibility. The second tranche, 0.2 euros per share, will be paid next June, through voluntary scrip dividend. This dividend is more than covered with our strong FCF per share, which stood at 0.88 euros in 2020.

7. ESG at the heart of our strategy throughout the pandemic

Our capacity to deliver to society was challenged as never before in 2020. We were able to sustain our business performance by keeping our ESG performance at the center of our strategy; which is based on three pillars: to help society thrive, build a greener future and lead by example.

For the first pillar, we continued our significant contribution to the countries in which we operate, 0.5% of GDP, as well as almost 1 million jobs. We also made significant tax contributions of 8.2 billion euros.

And we kept delivering on our already ambitious environmental agenda, beating our targets and setting new ambitious ones, aligned with the required urgency on climate change. We reduced GHG emissions by 61%, while continuing to increase our use of renewable energy to 88% of our total usage and reduced energy consumption by 81% relative to executing network traffic thanks to our network transformation plans. We have also contributed more than ever to the decarbonisation of the economy, thanks to the increase of digitalisation during the COVID-19 crisis.

The Group has also delivered sustained improvement in other key ESG metrics. Our customers and society in general valued our role and performance through the pandemic, and our reputation (measured through Reprtrak) reached a record of 66 (+10 pp over last year). Looking at gender diversity we achieved an increase of 1.8 percentage points to 27%, something I am proud of considering this figure was below 20% 5 years ago.

Among the range of ESG awards and recognitions we received throughout the year, I want to highlight that, for the second consecutive year, we lead the Ranking of Digital Rights, which is a prestigious third-party reference.

Finally, Telefónica is committed to achieving net zero emissions in our four main markets by 2025.

I will now hand over to Angel to go through a detailed review of the business performance.

Ángel Vila – Chief Operating Officer

FY & Q4 20 Results

Spain | Strategy proven right, preserved value

Thank you José María,

On slide 8 we show the performance of the Spanish business.

During Q4 we took steps to cool down pricing competition, enabled us to continue with our “More 4 More” strategy. We announced the fibre speed upgrade to 1 Gbps and agreements with DAZN and Disney Star to include their premium content in our offer.

These actions temporarily lead to lower gross adds and muted KPIs, but deliver positive results in terms of churn and value mix and add further sustainability to our business. By year end, the convergent base remained stable, ARPU improved in the second half of the year, and churn was reduced year-on-year.

Hence, the value of our convergent business has grown even within the toughest macro environment in decades.

In addition, we have the largest FTTH network in Europe, with the uptake reaching 29% as a result of higher accesses connected in both the retail and wholesale business.

Spain | Strong execution, recurrent and solid cash generation

Continuing with Spain, let’s move to financials on slide 9.

Service revenue accelerated its improving trend sequentially, across all revenue lines and especially in the second half of the year, mainly on the back of a solid convergent ARPU and record IT sales.

Continued cost containment and benefits from digitalisation led to an improved OIBDA trend quarter-on-quarter, with an OIBDA margin of almost 41% in 2020.

On the investment front, and despite having rolled out more than 2.1m FTTH premises and switched on 5G to cover 78% of the population, 2020 CapEx declined to 11% of sales.

As a result, T. Spain proved once again its ability to deliver solid cash generation amid very challenging conditions, with an OIBDA-CapEx of 3.6 billion euros, virtually flat year-on-year.

Finally, we are committed to achieving net zero emissions in 2025 in our operations.

Germany | Delivery of targets

Moving to slide 10,

Telefónica Deutschland maintained its strong trading momentum in Q4, with the O2 Free portfolio continuing its good traction and O2 contract churn registering historic low levels at 1.0%.

Our improved perception amongst customers is a result of a successfully equalised network quality as the Company met all its LTE coverage obligations. In the current mobile network test conducted by trade magazine Connect, the O2 network secured a "Very Good" rating for the first time, reflecting the enhancement in network quality driven by the 4G rollout.

In terms of financial performance, Telefonica Deutschland met all its full year revenue, OIBDA and Capex/Sales guidance.

Network development and targeted customer focus continued to drive growth momentum, with revenues increasing 2.7% year-on-year in the fourth quarter, whilst OIBDA growth continued to improve strongly, up to 3.4% year-on-year in Q4 versus 0.7% in Q3. Full year CapEx increased by 4.8% driven by investments for future growth in 4G, and in the 5G launch, now active across 15 cities.

And in terms of our sustainability efforts, Telefónica Deutschland's stated aim is to be carbon neutral by 2025. With 5G consuming 90% less energy per byte than 4G, we are very well placed to reach this target.

UK | #1 network in the UK

Turning to Telefonica UK on slide 11, we continue to be the UK's number 1 network. We have grown our base by 5% to reach over 36 million mobile customers, with market leading NPS and customer loyalty that continued to improve in 2020.

Looking at the financial performance, top line trends have been adversely affected by COVID impacts; however, with solid trading in the fourth quarter we saw improvements in mobile revenue from hardware and SMIP, containing the total revenue decline in 2020 to 4.4%.

OIBDA grew by 2.5% year-on-year in Q4 while declining by 2.4% in the full year 2020. It is worth highlighting that this is the fifth consecutive year of margin expansion in the UK business driven by our flexible operating model and continued efficiency gains. OIBDA-CapEx grew by 2.7% year-on-year in 2020 as a result of strong cost control and CapEx flexibility with an increased focus on growth areas such as 5G.

In line with the Group's ESG agenda, Telefonica UK has committed to become the first UK mobile network to achieve Net Zero carbon by 2025.

I'm also pleased to say that the O2 UK / Virgin Media JV is progressing to plan, and we expect it to close around the middle of this year. This transaction values O2 UK at 7.8x OIBDA and will create the UK's connectivity champion with joint EV of £38bn, with an expected cash inflow for Telefonica of £5.5bn- £5.8bn, subject to customary adjustments in this type of transaction.

Brazil | Growth in value and efficiencies driving profitability

Let's now move to the performance of our Brazilian operations on slide 12.

In 2020, we have reinforced our leadership in mobile with a record 33.6% market share and accelerated our transformation to fibre.

In contract, we added 729 thousand new accesses in Q4, following a more for more strategy and thanks to the increasing demand for high quality and reliable services. At the same time, churn improved to 1.1%.

In fixed, we passed almost 5 million premises with FTTH during the year, doubling what we did in 2019, for a total of 16 million. We want to continue capitalising on the fibre opportunity, using different models to address different profiles. In line with this we are in advanced talks to create a neutral wholesale fibre network vehicle where Vivo and T. Infra will hold stakes, targeting more than 5.5 million premises passed in four years.

Looking at our financial performance, we delivered outstanding OIBDA-CapEx growth of 8.5% versus 2019, with margin expansion of 2.5 percentage points. This outstanding result was supported by our continuing focus on driving OpEx efficiencies and optimising capital allocation.

On top of that, the acquisition of Oi's mobile business is progressing to plan, with closing expected in the second half of 2021. This will further enhance Vivo's position in the market allowing us to deliver even higher service quality whilst creating significant value through synergy generation.

Finally, on the ESG agenda, Brazil is committed to achieving net zero emissions in 2025.

Infra | Telxius: delivering growth, unlocking value

Moving now to slide 13, Telxius continued to deliver a strong performance, demonstrating the resilience of its business model throughout the COVID-19 crisis.

In the Tower business, the portfolio increased 46% year-on-year with the number of third part tenants up 15%, driving both organic Revenue and OIBDA growth above 40% year-on-year in the quarter.

In the Cable business, a second round of contract extensions with relevant clients was executed, resulting in an increase in net full contract value in the semester of approximately \$620m, despite a consequential short-term negative impact on revenues and OIBDA.

As a whole, Telxius delivered accelerated year-on-year revenue and OIBDA growth of 11.0% and 13.0%, respectively in the quarter, while the division's OIBDA-CapEx margin reached 46.9% for the full-year.

On top of all this, T. Infra successfully crystallised the value of our assets. Last month, T. Infra announced a landmark agreement with ATC for the sale of Telxius towers division in Europe and in Latin America as José María mentioned at the beginning of the presentation.

Developing fibre opportunity across our markets

Slide 14 shows how Telefónica has been focused on pursuing value creation opportunities in fibre.

Telefónica's footprint has grown exponentially in recent years, reaching almost 50 million fibre owned premises passed in 2020. Additionally, including our wholesale agreements our UBB footprint reached 135 million.

Penetration of UBB connections over total fixed broadband accesses rose to 77%, that is 6 percentage points more than in 2019, driven by a strong technological transformation that provides visibility to long-term revenues.

In Germany, as announced last October, we've signed an agreement with Allianz to create a neutral wholesale operator called Unsere Grüne Glasfaser, which stands for "our green fibre" in German. This new company has received approval from the European Commission, with construction starting this year and a plan of passing more than 2 million premises in 6 years.

In parallel, in Chile, we've announced the creation of a vehicle called InfraCo which will also enable us to accelerate fibre deployment with no CapEx impact and reach 3.5m premises passed by the end of 2022. T. Chile will contribute its footprint of 2m premises passed, at a very attractive 18.4x EV/OIBDA, while holding a minority stake of 40% in the company, while KKR will hold 60%. This transaction is expected to reduce net debt by 0.4 billion USD.

And in Brazil, we are in advanced negotiations with a leading international financial investor for the construction and offer of a neutral, independent fibre optic wholesale network. The new company, FiBrasil, that will also have the participation of Telefónica Infra, aims to accelerate the expansion of fibre to new locations, through a CapEx light model for T. Brasil, and capture value through third party penetration. T. Brasil is carving out 1.6m brownfield premises passed into FiBrasil and the target is to reach over 5.5m FTTH premises passed over the next 4 years.

As you can see, FTTH networks are fast consolidating their position as a core infrastructure asset class, with buoyant M&A activity at very rich valuations across geographies. Therefore, we have optionality to continue exploring further growth and value creation opportunities across our footprint.

Tech | Resilient and fast growing business

Turning to slide 15.

Revenues from Tech services (Cloud, Cyber and IoT/Big Data) grew consistently by 13.6% year-on-year in 2020 to 1.5 billion euros and proving it to be the fastest growing and most resilient business despite the challenges posed by the COVID-19 crisis.

It is important to highlight the competitive integrated portfolio, its strong operational capabilities, extensive commercial reach and its large base of B2B customers.

Growth was mainly fuelled by the Corporate segment, where Telefonica plays a key role in driving digital transformation, thanks to the Company's unique ability to address the converging demand for Cybersecurity and Cloud services.

Telefónica Tech companies are already established and running, with close to 50% of revenues already transferred to them. The new structure will help us to capture revenue growth and efficiency gains ahead. So, we met our targets and have outperformed the market once again.

I will now hand over to Laura to cover Hispam and financial results.

Laura Abasolo - *Chief Financial and Control Officer*

FY & Q4 20 Results

Hispan | Maximising value; reduced exposure

Thank you Ángel.

Turning to Hispam on slide 16.

Our focus remained on reducing exposure to the region, without jeopardising growth thanks to alternative investment models that have been implemented in the last few quarters.

Thanks to both this extra focus on value growth and our differential assets in the region, contract accesses and fibre connections showed a very robust performance, at record low churn levels.

Sound commercial performance in value segments was then coupled with efficiencies, fostered by acceleration in digitalisation and CapEx optimisation, that allowed us to post OIBDA-CapEx growth versus 2019, despite the tough year.

Let me highlight, we are reducing significantly the average capital employed, close to 20% vs 2019, leveraging on an asset light model through co-investments deals with ATC & ATP, the announced InfraCo in Chile, 4G sharing in Colombia and AT&T agreement in Mexico for infrastructure rationalisation among others. In addition, our capital structure improved with significantly increased leverage in Colombian and Chilean pesos, respectively. And finally, we are crystallising value through disposals, as demonstrated by the Central America sale, Latam towers sale to ATC and the announced InfraCo in Chile.

Mitigated FX impact on FCF

Slide 17 shows how FX headwinds are mitigated at the FCF level through our natural hedge.

The impact of FX in the fourth quarter was lower than in Q3. In 2020 FX detracted 6.5 percentage points year-on-year from revenue growth and 8.0 percentage points from OIBDA, mainly due to Brazilian Real depreciation versus the Euro.

Nevertheless, the negative impact of 1.2 billion euros at OIBDA level translated into just 231 million euros at the FCF level.

On the other hand, FX had a positive impact on net debt of as much as 1 billion euros in 2020, which increases further to 1.8 billion euros if we include leases.

Debt | Strong FCF and inorganic initiatives

On slide 18 you can see how strong FCF generation was last year, topping 4.8 billion euros, and comfortably allowing us to cover dividends, hybrid coupons and commitments, while helping to bring down net debt.

We paid down 2.5 billion euros to €35.2bn as of December 2020. Once we take Telefónica's recently announced strategic and inorganic initiatives into consideration, net financial debt will decrease by an additional 9 billion euros, to the €25bn mark.

And we remain committed to reducing our net debt going forward, through solid organic FCF generation (as proven even during the worst operating environment in decades) and further inorganic measures.

De-risked balance sheet

Slide 19 shows our proactive and innovative approach to financing in 2020, navigating a volatile market to raise 17.9 billion euros in total, including 6.3 billion euros related to the Virgin Media O2 UK deal financing. We have been at the forefront of ESG financing, as the first telco ever issuer to tap the green hybrid market, and more recently, as the first telco to issue a sustainability hybrid bond.

In addition, we have reduced our maturities to 2022 through 2 billion euros equivalent of Liability Management exercises in 2020 and 2021 to date.

And we have extended our average debt life to close to 11 years, while maintaining a robust liquidity cushion of 21.4 billion euros, which comfortably accommodates upcoming maturities. Should we include the recently announced inorganic deals, our maturities would be more than covered for the next 3 years.

All this financing activity has been executed at historically low interest rates, enabling us to reduce our effective interest cost to 3.11% as of December 2020, a 38 basis points improvement from the previous year.

I will now hand back to Jose María to wrap up.

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

Conclusion

2021 guidance | Recovery more evident from Q2

Thank you Laura.

2021 guidance, reflects our expectation that recovering and normalising trends will be more evident from the second quarter onwards.

We expect revenues and OIBDA trends to stabilise in 2021 in year-on-year organic terms, and CapEx to Sales to trend back to normalised levels of up to 15% of sales.

In 2021 we foresee no general confinements post the first quarter, a gradual recovery in global economy, especially as from H2 21, though conditioned to the trade-off between vaccine' coverage and the pandemic evolution.

This is the premise in which our guidance is based. COVID-19 impact is expected to be lower than in 2020, recovery to turn more evident as from Q2 21 with higher demand in B2B segment. This along with continued efficiencies in costs, and accelerated digitalisation measures.

In addition, there will be changes in the consolidation perimeter along 2021 derived from inorganic transactions. Guidance 2021 is calculated under organic criteria (homogeneous consolidation perimeter 2021 and 2020, and average FX 2020).

Having said that, the uncertainty surrounding COVID-19 and how the pandemic develops is a risk going forward, and despite anticipating some recovery for 2021, we will continue to manage our resources according to results evolution.

On dividend, we are announcing 0.30 euros per share for 2021, to be payable through voluntary scrip dividend, in December 2021 and June 2022. Our decision to adapt the dividend allows us to combine the need for financial flexibility in a year where several spectrum auctions concur, with expectations of a strong FCF generation and significant inorganic transactions. And still want to incentivise our shareholders and provide them with attractive but sustainable returns.

Key takeaways

And now to conclude, I'd like to leave you with a few key takeaways from today's results:

- First, we have proved our resilience in challenging times during 2020 and continued to deliver for all stakeholders. We delivered on our 2020 guidance and proved our cash preservation capabilities whilst strengthening our business positioning.
- Second, we executed material progress towards our strategic objectives, with reduced exposure to Hispam, value creation and realisation from Infra and Tech, as well as significant developments across our four core markets. Again, we sold our towers at the highest multiple ever, both for the industry and in Telefonica's history.

These achievements helped us deliver significant progress in de-leveraging, both organically and inorganically. Once the inorganic deals have been completed, net debt will be further reduced by as much as 9 billion euros, or 25% of year-end debt.

And finally, we are announcing a positive outlook for 2021 and dividend of 0.30 euros per share.

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

Q&A Session

Pablo Eguirón – Global Director of Investor Relations

Hello, everyone, and apologies for the delay. The operator is having problems with the line. And therefore, we cannot listen to her. While we wait for the operator to establish the connection, we can start with the Q&A via email.

So, **Georgios Ierodionou from Citi** is asking about fibre. He says that we have already done the deal in Chile and we have the one in Brazil on the way. The question is if the plan is to maintain control in Brazil, and what other options we have for similar deals in other countries in Hispam?

Ángel Vilá – Chief Operating Officer

Thank you, Georgios, for your question. We are announcing different formats of fibre deals depending on the objectives and the market conditions.

The deal that we announced in Germany is a deal of co-control to grow from a greenfield point of view. It's a deal structured 50% Allianz, and 50% Telefónica, to be held by both Telefónica Deutschland and Telefónica Infra. The aim of that deal is to grow in a greenfield manner.

Then the deal in Brazil is a different format of deal. We have divided the country into 3 tiers of towns and cities. Tier 1 is going to be developed with our own CapEx. This will be 100% owned by Telefónica Brasil. Then there is a second tier that we are addressing through either agreements with fibre owners like American Towers (like we did in Minas Gerais), or with the projected vehicle called FiBrasil where we will have co-control with a partner. 50% will be owned by the partner, the other 50% will be split equally between Telefónica Brasil and Telefónica Infra.

This is a deal which is slightly different from the German one because it has a brownfield component; Vivo will contribute 1.6 million premises and the rest will grow via greenfield and potentially through acquisitions, to reach 5.5 million in the next 4 years.

There could be other fibre deals in Hispanoamerica. We just announced the deal in Chile. These are countries where the fibre penetration is still not as high and there are opportunities to create value in the region.

Laura Abasolo - Chief Financial and Control Officer

We are very satisfied with InfraCo. We have created the largest neutral wholesale operator in Chile, and we have also maximised the valuation, with an enterprise value above \$1 billion, and that results in a multiple of over 18x EBITDA. Moreover, we will have a 40% stake in InfraCo, which will have greater value in the future.

This is serving many of the targets we have around Hispam, which is modulate exposure, but at the same time, go back to profitable growth, which we have already managed in 2020 despite the difficult conditions, and to continue contributing to net debt reduction. And this transaction is going to reduce net debt in approximately EUR 0.4 billion. I think there's some read across from this transaction because of the great value of our infra assets. If you look at the ultra-broadband premises passed in Hispam, those are over 12 million. And if you think we have been selling this at around \$500 per home, that would imply a total value just for the fibre in Hispam of USD 6.1 billion, just extrapolating that. And the value of the consensus right now, for the whole Hispam, is at around USD 7.7 billion. So, I think the opportunity and optionality here is huge. And, at the same time, this is compatible with continuing growing profitably in the region.

Pablo Eguirón – *Global Director of Investor Relations*

Thank you, Laura. The second question from **Georgios Ierodiconou of Citi** is about fibre in Spain. Is that something that you consider and what are the considerations that would prevent us from taking similar decisions understanding that you don't need the greenfield funding, but it can help with deleverage.

Ángel Vilá – *Chief Operating Officer*

Well, our operation of fibre in Spain is very well developed. Spain is a highly penetrated market. It's leader in Europe. It's a market where we have already several commercial agreements in place to wholesale the fibre. As you said in your question, there is not the greenfield opportunity that we see in the places that we are setting up new fibre cos with partners. We have a very valuable and very well-developed fibre in the country, which is for us strategic. It gives us optionality for the future, but we are not contemplating at this stage transactions regarding the fibre, it's strategic.

Pablo Eguirón – *Global Director of Investor Relations*

The next questions come from **Mandeep Singh from Redburn**. He asks that in Spain if there is any possible revenue contributions in the Spanish revenues coming from the joint venture with Prosegur, and how much? And if there is -- there are benefits from copper sales, I understand central offices in EBITDA.

The second question is regarding U.K. spectrum. If Tef will bear the cost and then contributed to the joint venture?

Ángel Vilá – *Chief Operating Officer*

Thank you, Mandeep, for the question. Regarding Prosegur, the joint venture is 50/50 owned. It's accounted by Telefónica Spain as per the equity method. So, it does not consolidate OIBDA from the Prosegur joint venture neither the revenues. Yes, Telefónica Spain is accounting in its figures the commercial commissions from selling to our customers the alarms that are being supplied by the Prosegur joint venture. So partially, the results are included in the terms of the commercial fees that Spain gets from selling those. But the results of the alarm activity itself are accounted through the equity method.

Regarding copper sales, we continue to decommission our legacy copper switches. This is allowing us to undo investments that we have in our perimeter, be it through selling real estate (which has been more active in prior years than this year), and also via selling copper; sales which are accounted as "Other revenues" in Telefónica Spain numbers.

Regarding the U.K. spectrum, the auction is expected to start in the month of March. It has 2 tranches of spectrum being sold. Since the JV has still not closed this is a process that will be run single-handedly by Telefónica. And the cost will be borne by ourselves, and then the asset will be contributed into the JV.

Pablo Eguirón – *Global Director of Investor Relations*

The next question comes from **Michael Bishop from Goldman Sachs**. The question is about free cash flow. Michael says, given the strong beat in 2020 versus your guidance of more than EUR 4 billion. Do you have a similar guidance or ambition for 2021 given consensus only EUR 2.5 billion free cash flow for 2021?

Laura Abasolo - *Chief Financial and Control Officer*

Thank you for the question. We do not guide on free cash flow, although we remain focused on delivering a very robust free cash flow, as has been the case in 2020, and also hope to beat consensus. Let me tell you that free cash flow is an absolute priority and we expect it to comfortably exceed dividend payments, the labour commitment and hybrid coupons payments, and will continue to be a sustainable driver for continuing deleveraging.

I will elaborate a little bit, although it will not be guidance, as I said at the beginning. But if you start from our operational guidance, we are expecting recovering and normalising trends that will be more evident from Q2. Those will stabilise and also CapEx to sales will trend back to normalised pre-COVID level of up to 15% of sales. This will put some pressure on operating cash flow year-on-year, but will allow us to continue capturing future growth.

Below operating cash flow, we will continue with our business as usual working capital measures, we will continue optimising our financial payments with our strategy that consider cost, but also life, currency and liquidity needs. For tax payments, we have a midterm guidance of 20% with the unavoidable volatility around advanced payments and refunds. In that sense, in 2020, we had some positives such as spectrum auctions being delayed for 2021, low level of payments in advance and also, as you know, we successfully hedged free cash flow and that also flowed through to financial payments.

But you can count on us managing every single line starting from stabilising operational trends and optimising all other financial items. And of course, CapEx and resources in general, there are still uncertainties surrounding COVID-19 and how the pandemic will develop, it continues to be a risk going forward. And despite anticipating recovering in 2021, we will definitely continue managing our resources according to the evolution of results.

All in all, we have proven resilience in challenging times and we have many levers to manoeuvre, and we have been closely monitoring our free cash flow generation, and will continue to do so this year. We keep on improving efficiency and prioritising our investments to adapt our expenses towards revenue and profitability generating sources. We will continue working in this direction, Michael. Free cash flow generation is a priority for us.

Pablo Eguirón – *Global Director of Investor Relations*

Then the next question is from **Mathieu Robilliard from Barclays**. Mathieu is asking about the business in Spain. If you can discuss recent competitive trends in Spain and what it will take to stabilise the top line and when.

Ángel Vilá – *Chief Operating Officer*

Thank you, Mathieu, for the questions on Spain. In this quarter, Telefónica Spain has shown market leadership by deliberately reducing commercial pressure during the first half of the quarter. We have been deliberately cooling down the market since late Q3, offering lower discounts and shortening promos. We were the first mover, and this has penalised our gross adds by early Q4, but other players followed us.

The Q4 campaigns on Black Friday, Christmas, have been softer than previous years. The promotions that could have been by some players, 50% for 6 or 12 months, are now generally reduced to 3 months promos. And we are seeing not only Q4, but also now that in February, all promos in unlimited mobile data have been removed by all players. And for instance, Orange is decommissioning some of its lower-end brands.

This has allowed, as I was saying in my speech, to enable “more for more” initiatives. We saw that from Vodafone in November, from Euskaltel in December and ourselves also in January '21. This decision, which was on purpose to cool down the market and had to be exerted by the market leader, will still hit us in our commercial metrics in Q1 because of the expiration of promos. But clearly, it's paying off in terms of market repair, it's paying off in terms of lower churn and it's paying off in bringing in high-value subscribers.

Churn has improved month-over-month in Q4 for all segments. The convergent gross add mix has improved sharply. 74% of the Fusion gross adds in the second half of the year are in the mid- to high-end, that is 19 percentage points more than in the first half of the year. ARPU is virtually stable quarter-on-quarter, and the year-on-year trend is improving.

So as you have seen, these results are allowing us to improve our revenue trends, are allowing us to comply with what we have been stating that ARPU in the second half would be higher than in the first half. And also cost control and efficiencies have allowed us to have OIBDA margin higher in the second half than in the first half.

Then your second question was regarding revenue stabilisation. What we see (and again, this is the outlook for Spain and this is not guidance and should not be taken as such and of course, it's highly dependent on the evolution of the pandemic), what we see is that the sequential revenue recovery trend has clear momentum.

We have been able to sustain the convergent base with growth in contract mobile and fixed broadband, especially in fibre. We are launching some "more for more" actions. We are getting traction from new digital services. This is in B2C, and in B2B, what we see is that we have achieved record growth in IT services that far more than offset the communications erosion.

Roaming should be recovering as the pandemic recedes. And wholesale will continue to be strong. All of these trends are supporting revenue in Spain towards stabilisation or even slight growth for 2021. At the same time, we are expecting OIBDA margins to be around the 40% level and CapEx to be benchmark up to 12% for the Spanish operation.

Pablo Eguirón – *Global Director of Investor Relations*

Also related to Spain, there are questions coming from **Jakob Bluestone from Credit Suisse** and **Joshua Mills from Exane**. I think that there have been already covered part because Jakob is asking about the outlook for Spain in revenues and EBITDA, but also regarding what we see ahead in terms of subscriber evolution.

This same question regarding the evolution of subscribers and the changes between high and low value is being asked by Josh Mills. And how we see in relation with this if we continue to see value in football content -- in sports content in general to continue including it in our offer. And if we would perhaps offer more football content to lower-end subs. And if this changes our view on how much this content is worth ahead of upcoming auctions.

Ángel Vilá – *Chief Operating Officer*

Thank you, Pablo, for your questions. On the outlook, I think that I elaborated. We see sequential recovery trend in revenues to have clear momentum, which should support the factors I mentioned before, stabilisation or even slight growth in revenues, with the OIBDA margin being around 40%. I should add that the second half will be better than the first half, given the comps and evolution across the year. And CapEx to be below 12%.

The question was also on the evolution of KPIs. Again, we are deliberately working at cooling down the market. We have a clear strategy of going for value, not for volume. Others may choose to go for better cosmetic KPIs at the expense of financials and sustainability. That is not our case. At the high end we are focusing on retention, and the low end, we are focusing on acquisition.

On the football, it has proven to be a commercial engine in the high end, especially in COVID times. We have been growing in high-end subs. As I was saying before, in the gross adds volume, the mix has been excellent in the second half of the year, 3 quarters of the gross adds have been in mid-to high-end. This has allowed the convergent ARPU to improve. I should also say that football gross adds in the second half have been double the ones of the first half. And we have also been able to get an improved ARPU in the second half than in the first half.

Pablo Eguirón – *Global Director of Investor Relations*

Then **Carl Murdock-Smith from Berenberg** is asking about the dividends and the guidance. On the dividend, he says, can you talk about the logic of cutting the dividend but maintaining a scrip option. Surely it would make more sense to cut the dividend to a sustainable level and pay it in cash than rebuild from there. How would you react to the acquisition of that persistent use of scrip option like a series of rights issues?

And then on guidance, what does stabilisation mean in numerical terms? There are two ways to think about the stabilisation, something around 0 or something closer to 0 than 2020 trend. And he thinks that the right one is the first one, a kind of minus 1% to plus 1% range.

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

Well, thanks for your question. Taking the first one on the dividend, the decision of proposing a dividend payment of 0.3 euros per share in a voluntary scrip option is based on the following framework.

- First, we want to speed up our internal transformation process and so we want to preserve a strong free cash flow generation and at the same time being able to invest in the growing parts of our business.
- The second one, keeping in mind that we keep on exploring inorganic options, and that is helping us to allocate capital into growth areas and at the same time reduce leverage. We will be closing transactions this year that represent an additional 9 billion euros of net debt reduction and additional funds flowing through the business
- 2021 it's a year in which we will be most likely facing spectrum auctions in 3 of our 4 core markets, in Spain, the U.K. and Brazil.
- We are still surrounded by some degree of uncertainty from COVID-19 impacts and although the outlook is positive. And keep in mind that we want to preserve a sound investment grade rating.

Taking all this into consideration. And I think that we think that it is important to preserve an attractive level of shareholder remuneration, we think that EURO.3 per share meets all the targets. It reinforces the company both strategic and financially, it provides flexibility in uncertain times, it accelerates deleverage and it provides an attractive return.

In terms of the preserving the scrip option we think that through a voluntary scrip we have been able to keep some flexibility and at the same time, offering greater optionality to our shareholders. Remember that two-third of our shareholders decided to reinvest their dividends. We think it's important to keep that flexibility once the outlook is still affected by COVID-19. Keep in mind as well that any excess free cash flow will be devoted to neutralise the dilution. In 2020, we have partially offset the dilution by cancelling 1.5% of the share capital and therefore the share buybacks are going to be used as a tactical tool to control the level of dilution to adapt to the excess funds coming from M&A when we are able to preserve some investment and grade rating. And therefore, in summary, we think that it implies more flexibility and at the same time, it can help us to accelerate our strategic transformation.

In terms of guidance, for us, stabilisation means that we see better trends, as has been describing in some of the markets, namely in Spain, we see better trends emerging, and we have momentum in operational trends. But we still have some uncertainties surrounding COVID.

COVID effects should be fading away all along the year, and that has significant impact in places like roaming or SMEs revenues or B2B or handset sales. Therefore, we see a progressive improvement in the metrics. So for us, stabilisation means close to stable, mildly positive, mildly negative.

Pablo Eguirón – *Global Director of Investor Relations*

Then **Keval Khiroya from Deutsche Bank**. He is asking 2 things. The first question is, could we have an update on the timing of inorganic actions in LATAM? Any views on how you are thinking about disposals versus spin-off?

And the second is, can you please help us to understand better the fourth quarter Spain retail revenue? You mentioned stronger support from IT revenues and improving trends in non-convergent revenues. Any more colour on what the extra support from IT revenues was would be helpful, and if the non-convergent revenue improvement is sustainable?

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

I'll take your question on LATAM. In November '19, we established as a strategic priority to reduce our exposure to LATAM in order to mitigate our exposure to FX volatility.

During 2020, a lot of things have been done. First, as Laura has been saying, we have moved towards an asset-light model. We have been doing a very selective CapEx allocation towards growth. We have become an MVNO in Mexico. We have accelerated network sharing agreements like the one that we have in Colombia. We have reduced capital intensity by selling towers and monetising fibre assets and, all those divestments have been done

at very attractive multiples. In the case of the divestment of Central America, above 7x OIBDA and in terms of towers or fibre assets in the high teens. In order to give you an example, as Laura mentioned previously, the fibre transaction in Chile has an implied value, per premise passed, of \$500. And that means that we have a significant optionality because we have 12.1 million home passed in LATAM.

We have also increased debt in local currency significantly. And as a result, we have reduced capital employed in Latin America during 2020 by more than 20%. We are moving into a lighter asset model, more naturally hedged structurally and easier to hedge in terms of free cash flow growth.

We will certainly keep exploring inorganic transactions but only if it creates value for Telefónica shareholders. In the meantime, we'll manage the region according to our strategic priority to reduce capital exposure to LATAM.

Ángel Vilá – Chief Operating Officer

Regarding the Spain retail revenue trends, let me try to give you some more colour. The fourth quarter revenues in Spain declined by 2.9% year-on-year. This rate is 1.5 percentage points better than in Q3 and would have been a positive 0.5% ex-COVID impact.

If we break it down between handset and service revenues, handset sales continued to have a weak evolution of minus 24.5% in the quarter, it was minus 26% in the third quarter. So still weak, while service revenues at minus 2.1% year-on-year have improved 1.5 percentage points versus Q3, despite roaming and lower comps because we have had other impacts, quite positive like IT in the B2B segment, with record growth at 23% year-on-year. We have also had new digital businesses positively impacting and wholesale has also been quite positive.

The tariff upgrade has contributed as well to this revenue improvement. So, if I were to break down the acceleration of improvement of trend between Q3 and Q4, the softening of COVID impact has been helping us, this IT reactivation to record high as well, we have had better performance of the consumer non-convergent revenues, far lower declines than previous quarters, and wholesale has been strong (but a little bit of a drag from some of the wholesale revenues).

All in all, ex-COVID, the top line in our Spanish operation would have increased 0.5%.

Pablo Eguirón – Global Director of Investor Relations

Then **Soomit Datta from New Street** also has questions regarding the Spanish business. He asks if we can provide an update on thoughts on the European recovery program implications for Spain and Movistar? And if we have an idea of potential timing of this process during 2021?

Ángel Vilá – Chief Operating Officer

Thank you, Soomit, for the questions. The Spanish government has already announced and set up plans for the European recovery funds which will be to the tune of EUR 140 billion for Spain in the next few years. Those have to comply with the priorities that have been set up by the European Union. We see opportunities in the digitalisation axis and also in the environmental axis, given that many of our new investments are going to go in the direction of net zero -- our net zero target in 2025. These digitalisation areas will amount to EUR 20 billion overall figure. This is more than the 20% European community threshold for digitalisation. So good news. We are already making specific proposals to benefit from these funds. And we think that we are best positioned to make the most out of these subsidies.

Materialisation of this would be later in 2021 and then in the years to come. So, we see a high chance of Telefónica benefiting from these measures. But as soon as they become more precise, we will be able to factor them in our outlook.

Pablo Eguirón – Global Director of Investor Relations

I think that we have to finish, but we have some final questions around the same topics because **Fernando Cordero Barreira from Santander** were asking about Spain and Hispam that I think that all the questions they have been already answered. And **Akhil Dattani from JPMorgan** is also asking about infrastructure that I think has been already answered, the Spanish KPIs that has been already covered, the guidance and what the stabilisation means that has already been covered, but he has another question that I don't think has been covered, which is the Spanish consolidation.

Akhil Dattani from JPMorgan says, there is a lot of speculation in the market at the moment on a Vodafone MasMovil deal. Should a deal materialize, how do you think it impacts your retail and wholesale outlook?

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

Well, first, let me frame the question and then I will pass it over to Ángel for the detailed operational impact. We think consolidation is welcome. It makes no sense that there are so many players in Europe. Let me give you to two specific references. Average mobile revenue per access in Europe is half the average mobile revenue per access in the US, according to Analysys Mason figures. And, the European telecoms sector investment per capita is something around EUR 94 while it is \$150 in the U.S.

So I think that consolidation makes sense, intra-market consolidation makes sense. We will certainly support that if that was to happen in Spain.

Ángel Vilá – *Chief Operating Officer*

Not sure that there is much more to add. Current market structure seems hard to sustain. That seems to be a consensus view now. It looks like a solution is needed and in-market consolidation may be one. We have always said that we are supporters of in market consolidation and if this were to develop, it would be supportive.

Pablo Eguirón – *Global Director of Investor Relations*

So thank you very much all of you. Apologies for the technical problems. Now let me turn the call over to José María to finish the call.

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

Before concluding, I would like to thank Pablo for his great contribution, commitment and dedication during his 10 years heading the IR team. I know it has been tough, but he was totally up to the challenge. Now it's time for him to assume new responsibilities within the group. And as you know, he has been appointed Chief Financial and Control Officer of Telefónica Tech, which is our fastest-growing unit. I'm sure he will excel in his new role as he has always done.

Thank you very much for your participation, and 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.