RESULTS

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Conference call transcript

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Introduction

Adrián Zunzunegui – *Global Director of Investor Relations*

Good morning, and welcome to Telefónica's conference call to discuss January-June 2022 results. I am Adrián Zunzunegui from Investor Relations.

Before proceeding, let me mention that the financial information contained in this document 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 & CEO*

Presentation

Q2 22 Results

1. **Strategic focus helps improved growth momentum**

Thank you Adrián.

Good morning and welcome to Telefónica's Q2 results conference call. With me today are Ángel Vilá, Laura Abasolo, Eduardo Navarro and Lutz Schüler. As usual, we will first take you through the slides and will then be happy to take your questions.

During Q2, our continued focus on our strategic objectives resulted in improved momentum, with accelerated revenue and OIBDA growth in reported and organic terms. Business performance was strong across our markets. In Spain we improved OIBDA y-o-y. In Brazil, we strengthened our leadership after the Oi mobile assets acquisition, while improving financial and operational momentum. In the UK, on the first anniversary of VMO2 integration, synergies are being realised, the company is back to revenue growth, has accelerated OIBDA growth and accelerated investments in digital infrastructure. Finally, Germany is progressing ahead of plan in 5G rollout, 50% population coverage, while financial performance remained robust. In fact, our German colleagues yesterday upgraded OIBDA full-year guidance.

We have so far over delivered and feel prudently comfortable for the full year. As such, and despite the uncertain macro environment we are updating our 2022 guidance. We currently don't see a deterioration of our operational and financial momentum, and now expect to be in the high-end of the "low-single-digit growth" range for revenues and in the "mid-to-high end" in OIBDA terms.

On the opportunities side, we announced this week a new fibre vehicle in Spain that will allow us to capture further fibre opportunity, alongside monetising at very rich multiples. T. Tech continues as a source of growth, successfully integrating acquisitions and reinforcing capabilities, which are attracting potential investors. T. Hispam's strong operational performance has increased optionality. In Spain, in-market consolidation is on track, and we should benefit from European Recovery Funds. Also, we believe there is room for an improving regulatory outlook in Europe, a potential tailwind for us and the sector as a whole. Within this context, and through the Kernel ecosystem, we are designing the Company for aiming a bigger stake of the digital economy.

And to note, the contribution to society via our network reach, our products and services, and our social efforts, to make technology more accessible.

2. **Improving trends, value accretive growth**

On slide 3, you can see our improving organic trends with revenue growth accelerating by 2p.p., service revenue by 1.9p.p. and OIBDA by 1.3p.p. vs Q1 22. Let me further highlight that all businesses are back to revenue growth during this quarter.

In reported terms, forex has been supportive in Q2 y-o-y, adding 5p.p. in revenue and 1 p.p. in OIBDA growth. We are back to reported group revenue growth in the quarter for the first time since Q3 19 despite being still impacted by deconsolidation effects, while underlying OIBDA growth improved sequentially by 8.6p.p. In the month of June, and under a “like for like” perimeter, we grew top-line by 12.1% and OIBDA by 4.5% y-o-y.

As for the revenue base, B2B revenue grew by 3.6% y-o-y in organic terms in Q2, whilst improving the mix with an increased contribution from the digital ecosystem development mainly in Spain and Brasil.

Networks wise, we expanded FTTH to 165m premises passed as of June, being world leader ex China, and 5G footprint is enhanced in core markets, enhancing our premium quality proposition.

Free cash flow improved sequentially in Q2 to €835m and is up 44% y-o-y in H1 to more than €1.3m.

Finally, and on the debt side, we have strengthened our balance sheet and guaranteed solvency, improving our funding and liquidity position, as Laura will explain later on. Including post-closing events, our net debt stood at €27.8bn with a stable leverage ratio vs. Dec-21, end of the period forex OIBDA, despite incorporating impact from Oi and Be-Terna acquisitions.

3. **Key financial metrics**

Turning to slide 4, you can see key financial metrics for the Group.

In organic terms, and once aggregating 50% of VMO2, revenues, OIBDA and OIBDA-CapEx grew solidly, by +5.2%, +3.4% and +4.1% respectively.

In reported terms, trends improved sequentially, though were still affected by changes in the perimeter which deducted 11p.p. from revenue growth and 3p.p. from OIBDA growth. As I said previously, as from Q3 onwards our reported changes y-o-y will be on a like-for-like basis.

Net income surpassed the €1bn mark in the first six months of the year, with €320m in the quarter.

And FCF was strong and a positive factor for net debt evolution, compensating part of the €1.4bn impact of core debt related to the Oi mobile assets acquisition and Be-Terna. Net debt stood at €28.8bn.

4. **Accelerated momentum trends despite challenging macro**

On slide 5, and as I highlighted at the beginning of the presentation, we posted growth in reported terms across all our businesses despite a challenging macro context. On a sequential basis, there was an acceleration in y-o-y growth in most of our operations.

Revenue and OIBDA in Hispam and Brazil are growing very strongly at double digit rates. German growth remains steady. In Spain we delivered improving performance and in the UK OIBDA is already growing in the mid-to-high single-digit range on synergies realisation. So, we have reinforced our positioning and managed inflationary pressures well.

Looking at inflation in more detail, we have been able to partially mitigate its impact thanks to the strong revenue management, with strong market position and pricing power.

On the OpEx side, we are not immune but have been taking measures to offset inflation-related impacts. Our exposure to energy costs is 4% of our OpEx; with a mix of variable, fixed and hedged contracts. We have renewable long-term agreements in place and 100% of our electricity is from renewable sources in core markets and Peru. We are pioneers in legacy shutdown and continue modernising our networks with fibre and launching 5G, which are more efficient in terms of energy consumption. Our wage cost base is well hedged across countries, representing at Group level 13% of revenue, significantly lower than most of our peers, while lease costs reached 6% of revenue. Finally, in CapEx terms we have as well less than average capital intensity with up to 15% of sales in 2022.

5. Updating 2022 guidance; dividend confirmed

Moving to slide 6, where we are updating our annual guidance.

Our first half results are above our guidance in terms of revenue growth, 4.2%, and in the high-end of expectations in terms of OIBDA growth (2.7%). CapEx to sales also stands below what we guided for 2022, 13% up to June. We have over-delivered despite a tougher than anticipated environment, and we remain prudently confident with our annual targets. We see in fact sources of potential upside, even taking into account existing uncertainties, and decided to update our guidance. We aim to comfortably sit at the high-end of the low single digit guidance range in terms of revenues, and at the mid-to-high-end of our range in OIBDA terms.

On shareholder remuneration, we paid the second tranche of our 2021 dividend last month through a voluntary scrip dividend, in which 74.5% of shareholders opted to receive new shares. For the 2022 dividend, 0.15€/share will be payable in December 2022 and another 0.15€/share in June 2023, both in cash.

Regarding treasury stock, the adoption of the corresponding corporate resolutions will be proposed to the AGM for the cancellation of the shares representing 0.4% of the share capital held as treasury stock.

6. Advancing towards our sustainability targets

Telefónica has made steady progress this quarter against our ambitious ESG goals. Here are some examples.

On the Environmental side, I would like to highlight that we are the first in the Telco sector to have our Net-Zero target validated by the Science-Based Targets Initiative; we are first in the sector to have joined the World Economic Forum’s 1 trillion trees initiative and our solar power JV in Spain allows us to offer our customers greener choices.

On the Social side, we continue to connect the unconnected, for example, with Internet for All in Peru 2.5m people in rural areas now have access to 4G; in the last 6 months we have provided employability training to almost 1m people via our foundation; and we mobilise our employees for social good, with 29k taking part in our annual Volunteering Day.

In Governance, we remain committed to sustainable financing with two new bond issuances. We have also increased our ambition and aim to achieve around 25% of total financing linked to sustainable indicators by 2024; and we have launched a companywide ESG training course with our updated Responsible Business Principles.

We are proud of the progress we're making and continue to seek opportunities that bring value to the Company and to society.

And now, I will hand over to Ángel.

Ángel Vilá – *Chief Operating Officer*

7. Spain

Thank you Jose María and let me start with the review of our businesses.

Telefónica Spain improved its commercial activity during Q2 across all services, with positive net adds in FBB thanks to our fibre expansion. I would also like to highlight the good reception of the new "miMovistar" portfolio launched in May, which already account for more than 10% of the convergent customer base.

Convergent ARPU stood at €90.1, up 3.1% y-o-y, while churn improved once again to 1.1%, its lowest level in the last six years. This is translated into the best ever NPS and proves our strong market positioning and the quality of our product offering.

Revenue growth accelerated by 0.4p.p. sequentially to 1.3% y-o-y growth, the 5th straight quarter of growth, driven by better service revenue growth and continued strong handset sales. OIBDA trend improved by 1.5p.p. sequentially to -3.4% y-o-y in Q2 22. OIBDA trends improved despite the continued impact from higher energy costs thanks to our focus on cost efficiencies like the headcount reduction program and the wireline network transformation.

Telefónica Spain maintains in Q2 22 a benchmark cash margin, OIBDA-CapEx of 25%.

8. Germany

Moving to Germany on slide 9, which delivered another quarter of strong operational and financial momentum whilst also celebrating O_2's 20th anniversary in the German market.

The 5G network roll-out is making strong progress, with 50% population coverage achieved well ahead of target. As a result, Telefónica Deutschland has raised its ambition for 5G population coverage to ~60% by the end of this year, with no change to CapEx guidance due to roll-out efficiencies.

There has been continued commercial momentum on the back of strong customer demand for the O_2 portfolio and a solid contribution from partner brands, with churn starting to normalise following the introduction of the European Electronic Communications Code in Q1.

Moving to financials, in Q2 revenue grew by 5.8% y-o-y and OIBDA by 3.1% y-o-y with improved operational leverage in both, fixed and mobile on the back of own brand momentum and some support from the recovery of international roaming.

The company continued to execute its 'investment for growth' programme according to plan in its final year, with H1 22 CapEx up 9.5% y-o-y organically. CapEx to Sales ratio peaked in 2021 and it is well on track to achieve normalised CapEx to Sales levels at the year-end.

Finally, Telefónica Deutschland`s OIBDA outlook has been upgraded to "low to low mid-single digit percentage growth".

9. Virgin Media O2

We now move on slide 10 to the UK, and our Joint Venture, Virgin Media O2, which celebrated its first birthday in June, and continues to integrate and transform at pace whilst also investing heavily to expand and upgrade its fibre and 5G networks.

In May VMO2 launched its first sustainability strategy as a joint business, the Better Connections Plan, outlining its bold commitments to cut carbon, champion the circular economy, such as recycling devices and donating unwanted smartphones and tablets, and support communities as it upgrades the UK.

This quarter, the company saw a sequential improvement in both mobile and fixed net additions following the successful implementation of price rises. This also helped VMO2 return to revenue growth in the second quarter, with accelerating OIBDA trends of 4.8% y-o-y which were also supported by cost efficiencies and the start of the realisation of synergies.

10. Brazil

Moving to Brazil on slide 11.

This quarter we consolidated the mobile assets acquired from Oi, which allowed us to further strengthen the leadership in the market, in accesses, spectrum and service quality.

Commercial activity was strong, leading to mobile contract accesses growth of 20%, or 8% ex-Oi impact, mainly thanks to improvements in churn that reached 1.0%, the lowest ever.

FTTH connections increased 25% y-o-y. FFTH is the driver of the FBB accesses growth, leading to the second quarter in a row with positive net adds. Fibre continued to expand to 21m premises passed, well on track to the 29m target by 2024 year end.

Organic revenue and OIBDA growth accelerated to +11.1% and +8.5% respectively and to +34.9% and +17.0% respectively in reported terms.

Excluding the Oi impact, y-o-y trends accelerated organically in revenues to 7.6% growth.

And cash conversion remains very strong with OIBDA-CapEx up +3.8% organically vs H1 21.

11. Tech, growing at scale ahead of the market

Moving to Telefónica Tech on the next slide.

This is a growth story; we have continued to progress in our objective to build a scaled European champion in Tech Services in H1 22. T. Tech has now ~5,500 highly skilled people, €1.2bn revenue base in the last twelve months and higher geographic diversity.

Solid y-o-y revenue growth continued, up +72% in H1 22, massively outperforming the market, with constant perimeter growth of 30%.

Commercial activity remains robust in both Cyber & Cloud and IoT & Big Data, with bookings growing by 70% y-o-y in H1 22 in both units, and increased weight of higher value services. This will support a strong revenue flow going forward.

In detail, in Cloud and Cyber we strengthened our partner ecosystem, with alliances with Netskope, Constella Intelligence and Cisco. In IoT and Big Data, we are accelerating in specific sectors, like Water Metering and Smart Stadiums, among others.

Finally, we had several positive recognitions by Industry Analysts (Avasant, Global Data) improving our competitive position in the EMEA region.

12. Infra, developing a leading portfolio of FibreCos

Turning to slide 13, our infrastructure portfolio manager, Telefónica Infra, has strengthened its portfolio with this week's announcement.

In Spain, we have signed an agreement to sell a 45% stake of Bluevia for €1bn in cash, valuing the Company at €2.5bn, an implied high multiple in the fibre space of 27.1x over proforma estimated OIBDA for 2022. Telefónica Group will keep 55% and the consortium of Vauban and Crédit Agricole Assurances, renowned long-term investors, the remaining 45%. The target is to pass 5m premises, of which 3.5m brownfield premises as of June, and to deploy the remaining 1.5m greenfield premises in the next 2 years. The growth of this Company is backed by Telefónica's commitment to switch-off its retail copper network in 2024.

In the UK, we continued to work in our new fibre JV process.

In Germany, UGG's operations multiple regions have reached more than 380k and premises under signed MoUs as of June 2022.

Meanwhile, FiBrasil, maintained its rollout momentum reaching a total of 2.5m premises passed in as of June 2022.

OnNet Fibra, in Chile, further increased its deployment with close to 200k additional premises passed; and in Colombia the OnNet passed just under a third of a million premisses in Q2 22.

During the first semester, Telxius subsea cable's good commercial momentum, together with good cost management, contributed to a y-o-y organic OIBDA growth of 6.4% and a high mid-teens figure on a reported basis.

I now give the floor to Laura, who will review Hispam's operations and the Group's financial results.

Laura Abasolo - *Chief Financial and Control Officer & Head of T. Hispam*

Hispam

Thank you, Ángel.

Moving to the next slide.

On Hispam, we continued to maximise growth, capturing the high demand for connectivity in the region, growing 19% y-o-y in FTTH and cable connections and 5% in contract accesses. Let me mention the significant recovery of mobile contracts net adds in Chile and sustained growth in Colombia, and the increased connections of FTTH in Chile and Colombia of 31% and 62% in June.

This was another quarter where our results have been very robust, posting revenue growth in every single country in organic and in reported terms. It is worth noting the supportive trend of Latam currencies, which had a strong positive effect on y-o-y reported growth, driving revenue and OIBDA growth of 18.4% and 33.4%.

Thanks to the transformation of operations, efficiencies and CapEx rationalisation, OIBDA-CapEx grew an impressive 27.9% versus H1 2021 organically.

Strong Balance Sheet, prudent management

Turning to slide 15, net financial debt at the end of June 2022 stands at €28.8bn and will be reduced to €27.8bn after post-closing events, that include net proceeds from the closing of Bluevia transaction, the FibreCo in Spain, the recovery of Telxius tax payments in advance, and the acquisition of an additional stake in Telxius. We also strengthened our balance sheet at the firm's net worth level, with shareholder's equity up 12.2% vs December 2021 to €24.9bn as of June-22.

We are well positioned to face any new market dynamic. Telefónica maintains a strong balance sheet derived from a prudent debt management as we have been refinancing in advance near term debt maturities with long term financing at historical low interest rates. Average debt life stands at 12.8

years and our debt is 76% linked to fixed rates for limiting the impact of the rise in interest rates on our financing costs in the coming years.

Also, our robust liquidity position that exceeds maturities beyond 2024 helps us to comfortably face any market environment.

Let me highlight Telefónica's pioneering position in ESG financing within the telco sector, surpassing the €10bn sustainable financing goal. In January, the company refinanced its flagship syndicated loan of €5.5bn, in May, successfully issued its first senior sustainable bond for €1bn and recently Telefónica Brasil's completed its inaugural SLB debentures for 3.5bn reais. So, we are truly committed to increasing our ESG financing, in line with target outlined before by Jose María.

On top of that, we have increased local debt to align it more closely with our FX exposure.

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

José María Álvarez-Pallete– *Chairman & CEO*

Improved growth momentum

Thank you Laura.

Our results published today demonstrated our improved growth momentum both in reported and organic terms and let me highlight again: we returned to revenue growth in all business during this quarter. In addition, we have a supportive FX backdrop and we are managing inflationary and macro challenges through efficiencies at OIBDA level and proactive debt management.

Commercial progress on FTTH and 5G are driving growth, with our investment focus on these new technologies, adding to better churn management and customer satisfaction. To remark, that we will continue to capture fibre potential growth with the announced vehicle this week in Spain.

We are updating our guidance for 2022, pointing to the "high-end" of the range in revenue growth, and to the "mid-to-high end" of the range in terms of OIBDA growth, as we remain prudently confident in our ability to carry our momentum through the second half. This is both a prudent and balanced approach between sources of potential upside and the uncertain macro situation.

We are taking steps forward in our envisioned telco industry evolution. We should move to common layers to enable any technical capability: from voice to state-of-the-art digital services, repositioning telcos into the value chain through digital enablers. The challenge is to make NaaS, connectivity for the Metaverse and the Web3 worldwide available.

And finally, and within these challenging times, we remain committed to help society, a cornerstone of our company mission to make our work more human by connecting lives.

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

Q&A Session

Pilar Vico– *Credit Suisse*

The first one is around the OIBDA margin in Spain. Your margins are the lowest ever as we can see in the historical chart, and I would appreciate some colour, please, around OIBDA margin outlook. What will we expect from here if you're balancing your cost cutting versus continued inflationary pressures and if the margin can actually rebound from here? And the second is around how much do you expect your energy cost to increase in 2023 versus 2022 at current spot rates? And also, maybe we've seen some weakness in enterprise divisions of Orange and BT today. How is your enterprise business developing?

Ángel Vilá – *Chief Operating Officer*

Thank you for your questions. Regarding the outlook that we see for the Spanish business, you were asking about the OIBDA margin, but let me give you the full view of the outlook.

First, on the revenue side, being prudently confident, we see continued momentum in our revenue line. We aim for slightly y-o-y growing revenues in 2022.

We see a market that is expected to remain competitive in the low end, rational in the high end. In this market, we see growth drivers on recovery of ARPU in consumer revenue. We see growth in digital services, and we also see B2B as one of the growth drivers driven by IT growth. Wholesale should remain quite stable despite the wholesale TV revenues being dilutive from August '22.

But all in all, we aim for a slightly y-o-y growing revenues for 2022.

At the same time, to your question, we expect higher OIBDA in H2 than in H1. Margin wise, we should remain in the high 30s, even expecting pressure from energy costs, but those at some point will start annualising compared to last year.

Some of the levers of the revenue growth that I was talking about before, such as IT or even handset sales, have a lower margin. This will be offset by deflation in H2 on football costs, the full kick-in of people cost efficiencies, and lapping or annualising of energy costs. We will continue, of course, generating efficiencies to offset the potential pressures in OIBDA. So, we expect margin to remain in the high 30s.

And as for CapEx, we expect a similar weight over revenues to 2021, which will allow us to continue to have a benchmark operating cash flow for the full year.

So, summing up, we are prudently confident on our solid revenue performance that despite lower margin than 1 year ago, are firmly contributing to an OIBDA that will show a better H2 than in H1 in absolute terms; and that would be the outlook.

On the second question on energy costs, this has been clearly a significant element which we need to manage in all operations. In Spain, we have now covered with long-term agreements around 50% of our energy costs. In Germany, we have 80% hedged in 2022. In the U.K., we are nearly fully hedged, in Brazil through PPAs and distributed generation, which are fixed for the next 5 to 15 years, we are covered by more than 75%.

So, we are dynamically managing this element of our cost function, which clearly has been impacting our margins this year, and we are progressing towards coverage of the 2023 energy costs, but we have to be mindful of market conditions, not to lock-in the record high prices that we're seeing now in the market.

You had a final question on B2B. On B2B, at group level, we are seeing resilient growth, we are 3.6% up in Q2 in organic terms in revenues.

In Spain, Q2 B2B revenues are growing. This is a combination of communications being flat and digital services growing high single-digit. In Brazil, our B2B is growing also high single digit. Germany is growing, but it's from a small base. In the U.K., we are suffering pressure with a decline of revenues of 15.6%, a decline but less than other competitors that have announced results today. And in Telefónica Tech, we are growing 72% in H1, 30% on a constant perimeter basis. Here, of course, as I was saying when I was reading my notes, we have a backlog of orders in Telefónica Tech that ensures revenue growth in the coming quarters. And in some of our geographies, especially in Spain, we are already seeing the benefit of the European recovery funds in our accounts

Joshua Mills – *Exane BNP Paribas*

The first one, I'd just like to get your perspective on Spanish commercial trends. And you talked about the high-end of the market being rational and the low end less so. Maybe in the past, you've given some detail on the shift towards the O2 brand. That would be interesting. And I also note that there has been a bit of a disconnect between your convergence and your broadband net adds with convergence negative and broadband positive. Is that because of second homes or product mix? So a bit of colour there would be great.

And then secondly, on a follow-up to Pilar´s question around next year, lease expectations. You talked about the fact that these aren't all inflation linked, but it would be great to get us to steer on where you see cash lease costs settling down both for this year and next, and that I know that is not part of your official guidance but it´s important to free cash flow.

Ángel Vilá – *Chief Operating Officer*

In Q2, our commercial performance showed an improvement on all type of accesses vs Q1. And we would like to highlight the positive net adds in FBB that we're leveraging on our new competitive commercial proposal included in the “miMovistar” portfolio. So, we are improving our convergence trends. And I should say that since we launched “miMovistar”, the sales of convergent offers are to the tune, although it's early days, of +10% compared to prior to launching this offer.

In FBB, we are in positive territory, both in postpaid and TV we have improving trends. This has been also supported by the lowest churn that we have in the last 6 years, 1.1%. It's the best since 2016, excluding, of course, the quarter that we had a lockdown. And we have the best the best NPS ever.

Our strategy has been resulting in a convergent ARPU increase of 3.1% y-o-y in Q2 in spite of the fact that in Q2, we always experience a seasonal factor, which is the downgrade of the end of football season that in this quarter has been less impactful than in previous years, leveraging on our new convergent portfolio.

Joshua Mills – *Exane BNP Paribas*

The only other datapoint I was going to ask about is the mix of product within your base; in the past, you kind of talked about the shift to O2, also Mi Movistar. I wonder if you could give any colour there as well.

Ángel Vilá – *Chief Operating Officer*

As you know, we stopped giving the breakdown of high, medium, and low value segments because the definition for us of those high mid- or low ARPU segments were different from our competitors. And in the end, they resulted in sharing some commercial sensitive information.

To help you understand the evolution of ARPU, what have been the moving elements on this? On the one hand, we had a more-for-more move in Q1 that now is in Q2 coming into full effect. We have a lower dilutive effect of promotions. We have a higher contribution of the SoHo portfolio, new digital services in our ARPU. At the same time, O2 (and this may respond partially your question) has a growing penetration, which is slightly diluting ARPU. And we had some rulings against some of our advertising revenues.

So, the moving parts of ARPU have led to an increase in Q2, which is higher than the increase we had in Q1 y-o-y. And we have had q-o-q a slight deceleration of ARPU due to the seasonal downgrades which I insist have been less pronounced than in previous seasons, thanks to the new Mi Movistar portfolio.

Laura Abasolo - *Chief Financial and Control Officer & Head of T. Hispam*

Thank you for your question. The increase in leases as we have seen in Q1, it's a natural consequence of the Telxius deal we closed in 2021. But as you are aware, that effect is more than offset by the strong positives derived from the transaction, not only in reduction of net debt, and the ratio, of course, also because of the record multiple from that transaction. You also have to take into account that in Q2, we are including some of the leases coming from Oi. Oi includes 2.7k sites, but half are expected to be divested to comply with the antitrust CADE remedy. On top of this, the FX in the same way it´s helping revenue on reported OIBDA, has the opposite effect in leases, and we have a high proportion of leases in Brazil. Also, interest rates are impacting and also obviously inflation.

But, let me remind you, that not all our lease contracts are linked to inflation. They may be linked to other indexes, not all the renegotiations happen at once. And we are actively negotiating with some of our long-term providers, everything related to that, not only inflation, energy pass-throughs and so on to minimise the impact.

So basically, the bulk of it is the portfolio reconfiguration, with Telxius now being a third party, FX and interest rates. And despite that pressure, you have seen that free cash flow showed a very solid performance y-o-y, and we expect that to be the case for the remainder of the year.

David Wright – *BofA*

I have two, please. I guess the first one is a little more strategic LatAm ex Brazil is performing well now. You've obviously gone through a process of decapitalisation of the segment, but it is still classified as non-core for you. Could you give us your latest thinking on the future of those assets, whether maybe there's been a change of decision with the improved performance?

My second question, Lutz, just wanted to understand the revenue growth in the U.K. And if I'm looking at this correctly, the organic revenue growth only improved 30 basis points or so from Q1 to Q2, and that's despite the pretty substantial price increases in the consumer segment. Yes, your enterprises outperformed BT today, but it looks like your consumer is significantly underperformed, or am I reading that incorrectly? Any colour on the moving parts there would be appreciated.

José María Álvarez-Pallete– *Chairman & CEO*

Thank you, David. I'll take the first one on Hispam. Our strategy remains intact regarding Hispam. We remain committed to modulate our exposure to the region aiming to increase our return on capital employed, which has already been happening over the last 2 years. We have been able to approach the region with a disruptive new operating model, both from an organisation and from an infrastructure perspective, and on that regard, allow me to say also that we have been able to perform the turnaround of the business and therefore, combining both things, we have been able to reduce capital employed in the region by 12% y-o-y and 33% since 2019.

Looking forward, what you should expect from us is to continue executing our strategy. And overall, we think Hispam faces a more favourable framework. So, you should expect from us to keep focusing on modulating our exposure and significantly trying to increase our return on capital employed.

Lutz Schüler - *CEO of Virgin Media O2*

So, you're right, our revenue overall has been grown by 0.2% y-o-y. When you look into the pieces Mobile, we grew by 2.2%, and that was driven by the price rise. Now we apply the price rise to airtime while our competitors apply it to handset and airtime. And therefore, you see a bit of higher revenue growth coming out of that. I think the bigger delta, obviously, when you compare it with the numbers also today released with BT, there's a couple of differences. So first of all, to be clear, we have not the price in the terms and conditions. So, we applied 6.5% and that gives customers immediately 30 days after the time to react, and the reaction was in Q1 and the reaction was pretty similar than a year ago. We have also excluded some customer groups who are still in the promotion period, so you will see over the year that the price rise is kicking-in for them. And when you compare that with BT, right, they have the price rise in the terms and conditions, the absolute number is higher. And, the reaction has to be seen when the customers are coming off their minimum contract length.

So you can expect our fixed ARPU to increase during the course of the year, not immediately, but also to be transparent here, we are seeing a higher demand from customers to negotiate harder when they renew their contracts. So, retention discounts are a bit under pressure, and when you look at the acquisition market, than more products around £30 ARPU are driving the net adds. So, there is some pressure in the market. We think we see it out of the cost of living crisis, but you can expect from us to grow ARPU during the course of the year. I hope that helps, David.

David Wright – *BofA*

It does. And just so I understand it was around 8% apply to mobile airtime, and it was about 6.5% applied, I think, to broadband pricing.

Lutz Schüler - *CEO of Virgin Media O2*

Almost correct. 8.8% on mobile.

David Wright – *BofA*

I guess I understand the points you've made, but to see those percentages driving just a 30 bps delta from growth in Q1 just seems very unusual.

Lutz Schüler - *CEO of Virgin Media O2*

Well, on the mobile side, we have exited DCP which is still a drag in service revenue, but, it's a growth in EBITDA. And this will wash out over the course of the year. So this is in service revenue, and it´s a pretty material drag, but it´s a growth impact in EBITDA. And you won't see that repeating next year.

Nawar Cristini– *Morgan Stanley*

I have two questions. And so firstly, on the U.K., there were a number of M&A headlines. Could you talk a bit about your M&A strategy at VMO2 and maybe discuss the main objective you will keep in mind when assessing any M&A opportunity in the U.K., just as a general framework? And just following up on B2B. Effectively, we saw a number of tough prints from a number of global telcos in U.S. and Europe, but there were also some good prints and within your portfolio. As you mentioned, the mix is also different with the U.K. looking tougher than others. So, could you discuss maybe why there is a disconnect between the U.K. and versus the portfolio in terms of B2B? Is that the exposure to legacy, which, should have an impact? Is it something? Any colour to understand the mix will be very helpful.

José María Álvarez-Pallete– *Chairman & CEO*

Okay. Thank you for your questions. I will take the first one regarding potential inorganic moves in the U.K. I would address it on two fronts.

On the infrastructure side Liberty Global and Telefónica have initiated discussions with a number of potential financial partners regarding the opportunity to participate in a network built joint venture in the U.K. The focus of that JV will be to build a full fibre network of up to 7m premises in new greenfield areas by the end of 2027. What we can say at this stage is that discussions are ongoing, and we have had a good level of interest but there are no further new updates at this stage today.

In case of further inorganic transaction, unfortunately, as you might imagine, we don't comment on market speculation

Ángel Vilá – *Chief Operating Officer*

On your second question on B2B. I was saying before that at the group level, we are seeing a resilient B2B growth of +3.6% organically. And this is the result of very different situations across different markets. One of the differences comes from the market position, the strength of the fixed-mobile convergence and digital services position and the commercial force. We are very strong, for instance, in this in markets like Spain, in Brazil, in several of the markets in Hispam. And these are markets where you can see us growing.

We started long ago the transformation of our B2B business. In the face of pressures on the traditional communications, we started developing and accelerating our digital services proposition for B2B, and this allowed us to create our specialist unit Telefónica Tech on areas that we identified early as growing areas: cloud, cybersecurity, IoT and Big Data. And we believe that this is a determinant factor for the performance that we are seeing in our B2B operations in those markets where we have a really strong established B2B presence, as I said before.

In other markets like the German market, we have been more traditionally customer-centric and more mobile-centric. So, it's a small base that we are growing. And in the U.K., maybe it has specific characteristics linked also to the dynamics linked to the concerns on the cost-of-living crisis.

Before I hand it over to Lutz to give more colour on the U.K. B2B, I should say that we already see results from the European Recovery Funds in our Spanish operation. We see a revenue opportunity in the coming years that could even exceed (the whole opportunity) €20bn out of the €70bn of non-refundable aid that will be devoted to digitalisation. We are in a very strong position to capture a relevant share of this, and we aim to capture over the coming years up to 2025, up to €2bn, around 10% of that opportunity.

And we are already seeing results of this, not only on direct awards, but especially on awards that are being done to customers of Telefónica to which we provide digital services to, and in particular on the digital kit project that has already started for SMEs digitalisation.

We have created specific products and specific processes to capture the share of digitalisation of SMEs who get checks or bonds from the administration that then they have to spend in digitalisation, and we are already materialising part of that money.

So, I would tend to think that in addition to our very strong capabilities and market position in certain markets, we also have this tailwind, which is coming to help us. On the specific U.K. situation, I'll pass it to Lutz.

Lutz Schüler - *CEO of Virgin Media O2*

The biggest drag for us is not the cost of living crisis, the biggest drag is that in Q2 21, we had massive dark fibre wholesale installations. So, for instance, you use that for mobile backhaul linking 5G base stations and so on. The character of these deals, is that that you can recognise revenue and profit right away after installation. And that has driven a huge growth a year ago in terms of revenue and EBITDA. And obviously, it's nonrecurring as we are not installing on the same level this year, and therefore, you will see a big delta.

The smaller piece is that we have had a bit of a supply challenge on devices for our smart metering program, so installation was a bit less, but we will make up for it during the course of the year. And, as Ángel said, we see the same thing. The B2B digital services are growing more and more. And so I think you expect in the future, a different set of numbers. Cost in living crisis is not directly impacting us as far as we can see in the B2B sector.

José María Álvarez-Pallete– *Chairman & CEO*

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.