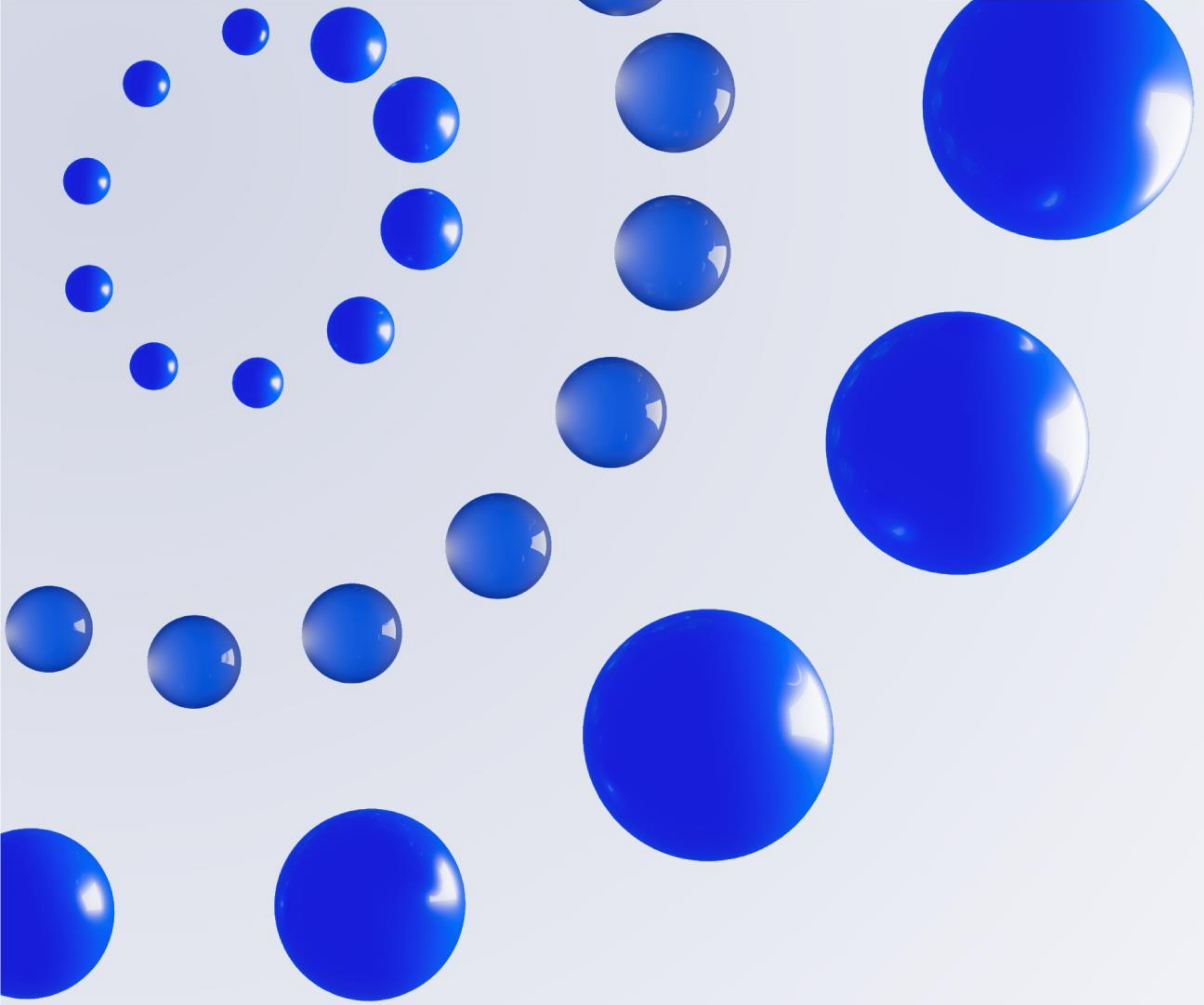

Telefónica

Results 2023 Q2

Important Notice:

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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 2023 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.

This conference call and webcast, including the Q&A session, may contain forward-looking statements and information relating to the Telefónica Group. These statements may include financial or operating forecasts and estimates or statements regarding plans, objectives, and expectations regarding different matters. All forward-looking statements involve risks and uncertainties that could cause the final developments and results to materially differ from those expressed or implied by such statements.

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 CEO, MR José María Álvarez-Pallete.

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

Presentation

Q2 23 Results

1. **Delivering our goals**

Good morning and welcome to Telefónica's second quarter 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 the second quarter, we continued to focus on our strategic objectives and successfully delivered on our goals.

We improved our position in all our core markets. In Spain, retail revenue growth improved, and we progressed towards OIBDA stabilisation. In Brazil, OIBDA-CapEx performance was stellar, with more than 30% annual growth while revenue grew above inflation thanks to strong operational performance. In Germany, H1 23 showed a strong performance and continued momentum, with excellent progress in 5G deployment to 90% pop coverage in a normalised CapEx to sales envelope. Finally in the UK, we accelerated the network roll-out in UBB and 5G along with a sequential improvement in revenue and OIBDA growth based on synergies, which we are executing above plans.

We see opportunities from in-market consolidation in Spain and the UK over the next years. In Spain, copper switch-off in April 2024 is an important milestone. In Brazil we focus on growth and lower capital intensity and the B2C ecosystem opportunity. In Germany, good customer demand of M2M tariffs underpins future growth ambitions and in the U.K., we will benefit from synergy realisation until 2026.

Group wise, T. Tech continues to outgrow its market, with solid revenue growth, and continued to be a source of value, while T. Infra further developed our fibre vehicles and looks for consolidation opportunities. T. Hispam announced two important deals, the MoU network sharing agreement in Colombia with Tigo and the agreement with KKR and Entel to create the largest neutral wholesale fibreCo in Peru. 32 telcos have already joined Open Gateway initiative, and we are fostering the development of artificial intelligence based use cases. Finally, from a regulatory point of view the next months are key for fair share regulation and consolidation, among others.

2. Driving profitable and sustainable growth

On slide 3, and on our second quarter results, that showed increasingly profitable and sustainable growth.

This is the fifth consecutive quarter of reported revenue growth, thanks to strong commercial momentum in value accesses, backed by increasing coverage of next generation networks that helps strengthening the relationship with our customers, with sustained high NPS levels. Along these lines, service revenue grew 3.4% year-on-year showing the pricing power we built in our business. B2B, that grows 6.9% year-on-year, remains a strong driver as well as we continue to outgrow both our peers and the markets in which we operate.

The above also results into low churn levels, which coupled with cost efficiencies and digitalisation measures, helps to improve organic OIBDA growth sequentially, as much as 2.4 percentage points vs the last quarter to 3.5% year-on-year growth. This trend is visible in all core units. This operating leverage in the business is the main driver behind the higher margin.

Contained capital intensity and active management of all FCF lines, notably in our debt cost, helps operating performance to flow through FCF, which is almost twice what we generated in the first quarter of the year, and grows year on year to €842m, for a total €1.3bn in the first six months of the year.

To sum it up, improved OIBDA and FCF momentum.

3. Financial update

Moving to slide 4, for the detailed financial update.

In organic terms, revenue, OIBDA and OIBDA-CapEx grew in the second quarter by 3.3%, 3.5% and 3.4% respectively.

In reported terms revenue grew 0.9% year-on-year and OIBDA was stable despite the negative FX impact this quarter.

Net income increased 44.5% in Q2 23 to 462 million euro, reaching 760 million euro in the first half of the year.

FCF reached 842 million euro in the quarter and 1.3 billion euro in H1 23, while June net financial debt declined 3.9% year-on year to 27.5 billion euro.

4. Strong momentum supports 2023 guidance upgrade

Moving to slide 5, where we show how strong H1 performance and the expected evolution of our business, thanks to strong commercial and operating momentum, give us confidence to upgrade our Group guidance for 2023. We are moving up from our previous guidance of "low single-digit growth" for both revenues and OIBDA to

- Organic revenue year-on-year growth of around 4%
- Organic OIBDA year-on-year growth of around 3%

We keep our CapEx to sales organic guidance unchanged at "around 14%"

This upgraded guidance at both revenue and OIBDA, coupled with unchanged capital intensity levels makes us feel extremely confident with FCF generation for the year. We expect to stand above latest consensus estimates and generate significantly more FCF in the second half of the year, for a full year FCF figure that, excluding spectrum, should not be far from the €4bn mark.

Furthermore, we will propose to the AGM the adoption of the corresponding corporate resolutions for the cancelation of 1.4% of shares held as treasury stock as of 30th of June 2023.

This, together with our confirmed €0.30 2023 DPS (we will be paying the first tranche of 2023 dividend, 0.15€/share in December 2023 and the second tranche, 0.15€/share in June 2024), implies a very attractive shareholder remuneration scheme.

A consequence of our strong confidence in our FCF generation capacity.

5. ESG progress

Turning to page 6, I would like to provide a glimpse of our progress across the pillars of ESG.

On the Environmental side, VMO2's net zero targets have been validated by the renowned Science Based Targets initiative, a validation received by Telefónica Group last year, the first in the sector to achieve it. We have also introduced takeback, reusing and recycling targets, in line with a sector push to address the circularity of devices.

With regards to the Social pillar, we continue to connect more people directly and via network agreements to improve and extend coverage. We also helped to boost around 1.2 million people's employment prospects via our Foundation. Within the company, women now represent just over 32% of executives, positioning us well on track to achieve our 2024 target of 33%.

On the Governance side, we highlight the award by Global Capital for our sustainable finance issuance, the launch of our ESG Academy to provide training for our employees, and that we are protecting our customers from cyber-attacks.

I will now hand over to Ángel to give you an overview of the progress across the operating businesses.

Ángel Vilá – Chief Operating Officer

6. Spain

Thank you José María.

Moving to slide 7, we review T. España performance.

Q2 results again confirmed a stronger commercial momentum and OIBDA trend improvement.

FBB and contract customers simultaneously grew year-on-year for the first time since the pandemic, our leading churn remained at historic lows and our industry leading convergent ARPU kept growing year-on-year. NPS remains best-in class and increased by 10 percentage points year-on-year to 48%. This allowed us to increase customer lifetime by 23% year-on-year to 9 years.

All this proves the leading position of Movistar in a competitive but rational market and the benefits of our strategy to focus on value share. As such, we continue to build on our smart bundling experience and premium assets. Recently we have announced the update of our convergent portfolio adding more value and the launch of a new OTT proposal, another step to further boost commercial activity and top line growth.

Service revenues in Q2 maintained momentum, while retail revenue year-on-year growth accelerated by 0.2 percentage points vs. Q1, on the back of tariff updates, improved commercial activity and sustained double digit growth in IT revenues.

OIBDA decline slowed to 1.0% year-on-year and it is progressively stabilising (+0.7 percentage points improvement vs. Q1) driven by lower content costs and network transformation efficiencies, which gives us confidence to continue to aim for stabilisation at some point in the second half of the year.

OIBDA-CapEx margin remained at benchmark high levels despite a higher CapEx intensity in Q2 which will soften in H2 23.

7. Germany

Moving to Germany on slide 8, which continued its robust growth path, with another quarter of good operational traction and sustained financial performance.

The Company implemented it's "more-for-more" strategy across all brands and portfolios, which has been well received by customers. There has been good commercial traction on the back of strong own-brand momentum and normalised churn rates.

T. Deutschland made good progress with the densification and further roll-out of its 5G network, all within a normalised CapEx envelope. As a result, 90% of 5G pop coverage target set for the year was already achieved in Q2.

Organic revenue was up 4.4% year-on-year, while OIBDA grew 2.8% year-on-year, accelerating 1.1 percentage points quarter-on-quarter supported by improved operational leverage mainly in mobile, which was partially offset by anticipated cost increases.

Finally, the Company narrows their FY 23 revenue and OIBDA outlook to "upper range of low single-digit growth" on back of strong H1 performance and continued momentum.

8. Virgin Media O2

We now move on to slide 9, to the UK and our joint venture Virgin Media O2, that continues to focus on expanding the UBB network, which now covers a total of 16.4 million premises, and with 5G connectivity now available in over 2,800 towns and cities.

Amidst a tough economic climate, fixed and mobile price rises were implemented during April and May, and are starting to flow through to Q2 figures. O2 mobile contract churn showed a modest improvement to 0.9% driven by loyalty initiatives.

Revenue growth accelerated to 6.2% whilst OIBDA reached 3.7%, both sequentially improving underpinned by Nexfibre construction revenue and the implementation of price increases. OIBDA performance reflects ongoing synergy realisation, which stands above plans, and which will support future OIBDA growth.

VMO2, within its ambitious Better Connections Plan, has announced a reduction in carbon emissions of 29% (scope 1 & 2) against the 2020 baseline and its net zero targets, across the value chain, were validated by SBTi.

9. Brazil

Moving to Brazil on slide 10.

Vivo continued to achieve strong results despite Oi annualisation since Q2 23.

We have been consistently increasing our market share since the Oi mobile acquisition, reaching a mobile market share of 39%, 44% in the contract segment.

The improvement on the accesses' quality, coupled with upgrading and price increases results in 8% growth in mobile ARPU, while contract churn continued its declining trend to 1.0%, its lowest level ever.

Revenue grew by +7.6% year-on-year in Q2 23, well above inflation, which together with cost discipline and the reduction in CapEx intensity, allows us to deliver an exceptional +29.2% year-on-year growth in OIBDA-CapEx in the first half of the year.

10. T.Tech, a global next-generation IT provider

Slide 11 reviews the performance of T. Tech, our leading IT provider for B2B digitalisation.

T. Tech has completed a 3-year cycle as a fully operational company achieving a leading position as a provider of high-value integrated solutions in EMEA and the Americas.

T. Tech is now entering a new cycle with a new organisational model. In Q2 23, businesses and portfolio have been unified to provide the best service and maximise the opportunity in all markets. Cloud will be the enabler of IoT, Big Data and AI, and Cybersecurity will be embedded in all the processes. This new operational model together with the global extension of capabilities will create synergies and make T. Tech more efficient and further increase its contribution as a key differential growth driver for Telefónica B2B revenue.

In Q2, T. Tech outperformed the market again, with 36% year-on-year revenue growth. In constant perimeter, revenue growth accelerated by 2 percentage points to 29% year-on-year.

Our highly skilled team of ~6.2 thousand professionals, with close to 4 thousand certifications in strategic partners' technologies, continue to be the key asset for T. Tech to deliver a differentiated digitalisation journey.

Our visibility of future revenue is high, supported by an increase in LTM Bookings of 35% year-on-year.

11. T.Infra, consolidating our leadership of FibreCos and critical infrastructure

On slide 12, at Telefónica Infra we crystalised the value of our assets and capabilities.

First, we continue to execute and scale up our fibre plans and have already passed 19m premises in underserved and/or low-density areas, after incorporating PangeaCo in Peru. T. Infra continues adding to Telefonica Group leading worldwide position in FTTH deployment.

A few weeks ago, T.Hispam reached an agreement with KKR and Entel Peru and will hold 36%, 54% and 10% stakes respectively, in the new Company. It will be the 1st nationwide open access wholesale fibreCo with a target of passing 5.2 million premises at the end of 2026, doubling the current footprint.

To highlight also that Nexfibre is since June commercially live across the UK and consumers can already connect to Nexfibre's hyper-fast network with the latest XGS-PON architecture.

Telxius, the critical digital infrastructure with 7 next generation subsea cables built since 2018, posted the sixth consecutive quarter of organic OIBDA growth and expanded OIBDA margin by 1.7 percentage points to 53% in H1 23.

I will now hand it over 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*

12. T.Hispam, capturing value growth opportunities

Thank you Ángel,

Moving to T. Hispam.

We continue with the execution of our strategy, to reduce the exposure to the region and make the business more profitable.

- On June 12th, Telefonica Colombia signed of an MOU with Millicom for sharing the mobile access network in Colombia. This agreement will help improve the quality of mobile services, and lead to a more efficient use of resources.
- In addition, T. Hispam reached an agreement with PangeaCo in Peru as Ángel mentioned before.

Overall results were solid. Revenues were virtually stable year-on-year despite a tough competitive environment while OIBDA continues to be affected by the growth of commercial costs driven by FibreCo model. However, we expect a better OIBDA trend in the next quarters, and we maintain our ambition to grow OIBDA-CapEx in 2023.

13. Further deleverage, sound liquidity and contained cost

Turning to slide 14, Telefónica maintains above 80% of its debt linked to fixed rates, mainly in Euro, with an average life of 12.4 years, which places us in a comfortable position to face any market environment.

We maintain a solid liquidity position of 20.2 billion euro that together with a light maturity profile, allows us to cover debt maturities over the next three years.

Meanwhile, net financial debt declined from 28.6 billion euro in June 2022 to 27.5 billion euro in June 2023. Net debt to OIBDAaL ratio improved from 2.79x to 2.62x in the same period.

We have also contained our debt-related interest cost at 3.47%, thanks to the active refinancing exercise undertaken along previous years and the solid position at fixed interest rates in strong currencies that allows immunisation to the environment of rising interest rates.

I will now hand back to José María who will explain the completion of our transformation journey and wrap up.

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

14. Future-ready

Now at the end of the presentation let me talk about the transformation process we have gone through, enabling us to deliver these strong results, allowing us to upgrade the guidance and making us feel optimistic about the future.

As Telefónica we have always been at the forefront of technological change to ensure our success in the future; change is in our DNA.

We transformed the way we serve our clients, turning our networks into next-gen infrastructure that transport more and more data with systems that store more and more information with massive processing capacity. We were early to invest in Fibre & 5G and are now the first scale telecom operator to shut down its copper network, but that is just the most visible technological change. We have virtualised and softwarised our networks and used AI since 20 years ago. We are now at a stage where we can do real-time service customisation and are able to offer NaaS and network slicing.

Technology has helped us transform our revenue function and we now generate close to 75% of our service revenue from broadband and services over connectivity, up from 45% in 2016. We made our organic revenue grow again for the last 9 quarters. We grow in B2C, where we hit record lows in churn when at the same time NPS has never been higher, thanks to this new way to interact with customers. We built digital ecosystems to capture new revenue opportunities. We outgrow both our peers and the market in B2B. We have increased our wholesale capacity.

We have as well transformed our OpEx and CapEx functions. 83% of our processes are now digitised, from 50% back in 2016. We have taken huge steps in virtualisation, softwarisation and automation towards zero-touch networks.

Capital intensity continues trending downwards, from 16.7% back in 2016 to 14% at the end of 2023. Deployments are mostly behind, and legacy shutdowns are mostly digested.

With this technological transformation we have positioned ourselves to fully benefit from the next wave of growth and emerging business opportunities. We are ready for the future.

15. Time to grow our ambition

Moving on to slide 16, we have further confidence in our ability to continue to deliver strong and growing FCF generation in the coming years. To be precise, we are projecting FCF growth in the next 3-year Strategic Plan, which we plan to detail in a Capital Markets Day to be held in Madrid on November 8th, together with our Q3 results' release.

As said, FCF growth is the ambition behind this new plan, on which we have been working since late last year, based on four main pillars:

- Our company and sector vision, including a new company program based on growth, profitability and sustainability; GPS
- With our customers at the centre. Through technology and automation, we will continue to have a better understanding of our customers' needs and create better customer experiences. Always aiming at long-term satisfaction, with customer empathy at the core.
- Technology and AI to continue the transformation process of Telefonica. We have been using technology for years to shape our company for the future. We will continue doing so, both internally and externally.
- With efficiency as the ultimate driver of decisions, and a clear focus on FCF growth to increase financial flexibility, reduce leverage and reward shareholders.

Key levers behind FCF growth are the following:

- Revenue growth: we are growing again our revenue since Q2 21 organically. We aim to maintain this strong momentum backed by a growing digital business (including Tech and digital B2C ecosystems), the ARPU up policies across our B2C operations, our differential B2B growth and new API-based ways to monetize next-generation networks to allow us to continue this path of profitable growth.
- And again, efficiency. We continue exploring sources of efficiency at both the OpEx and leases level (deriving from legacy decommissioning, AI driven softwarisation of networks and CRM, content optimization and others) which we will share with you at our CMD. We also aim to continue to optimise CapEx, via legacy switch-offs, traffic optimisation, AI/softwarisation, sharing, etc…that should allow us to further reduce capital intensity.

We are very much looking forward to greeting all of you in our premises on November 8th, where we will share all the details.

16. Driving profitable growth, increasing ambition

To recap on slide 17,

Q2 posted good earnings momentum and continued to deliver value for our shareholders.

First, we remain confident in our strategy and in our ability to maximise value for shareholders. Revenue and OIBDA grew organically and OIBDA improved sequentially on the back of our operating leverage.

Second, we continue to build on our network leadership and remain on track to expand our fibre to the home and 5G coverage. Thanks to our pioneering in digitalisation and AI application we are in the best position to increase efficiency and capture new opportunities such as Open Gateway.

FCF improved in Q2 23, and we expect this to continue along 2023. As such, we remain committed to maintain an investment grade credit rating and to leverage reduction.

Third, guidance for 2023 is upgraded based on strong revenue and OIBDA momentum, we will amortise 1.4% of treasury stock and we confirm our dividend for 2023.

We expect this strong momentum to continue going forward. Save the date for the Capital Markets Day we are calling for next November 8th, where we will present our new 2023-26 strategic plan and company vision, with a clear focus on growing FCF.

We have been working on this plan for several months and are very excited about what we are seeing. Full details will be shared then, but we have a solid starting point for a bright FCF outlook for the next years.

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

Q&A Session

Yemi Falana – *Goldman Sachs*

A couple of questions from me. Firstly, the Spanish macroeconomic picture is beginning to look uniquely strong in the European context with improving growth and low inflation, how does that impact how you're thinking about pricing into 2024?

And then secondly, maybe a bit more big- picture. Free cash flow remains strong, and I believe you're now targeting €4bn this year, which looks ahead of consensus as far as I can tell. Into the CMD, how are you thinking about rewarding shareholders alongside that free cash flow growth? Any kind of high-level thought processes would be super helpful.

Ángel Vilá – *Chief Operating Officer*

The first one on the Spanish macro. We are seeing no impact of the current economic conditions on any significant way on our performance. You have seen that the second quarter, or the first half of the year, we have had positive momentum commercially. We have had the highest NPS and lowest churn in spite of what could be the highest price increases we have passed on to our customers historically. We see this commercial momentum, if anything, improving in the second quarter, and revenue clearly has been accelerating, OIBDA has been on track clearly towards the stabilization that we aim at for this year. On the B2B segment, which could be or has been in other moments in the past feeling the impact of macroeconomic conditions, we are seeing a very solid growth in the B2B business. We feel that our business is well adjusted to manage the evolving macro conditions. Regarding potential pricing implications going forward in the next year or so, we will adjust to market conditions as we see fit.

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

Taking your questions on the free cash flow, as we have been stating, we are starting from a very solid position this year. And now we have been mentioning our vision of approaching the €4bn mark this year, excluding spectrum. According to the job that we have been doing, we are projecting free cash flow growth for the next years, based on the leverage that we have also shared with you, and we intend to use this free cash flow to keep reducing debt to gain financial flexibility and for sure, reward our shareholders. Details will be shared on the Capital Markets Day.

Keval Khiroya - *Deutsche Bank*

Firstly, Q2 showed modest conversion to ARPU growth in Spain, perhaps impacted by the temporary switch off of the football packages, should we expect conversion ARPU growth to accelerate in H2 versus the 1.5% growth you delivered in the first half?

And then secondly, can you share with us how you're currently thinking about leverage? On Slide 16, you highlight reduced leverage and increased financial flexibility within the pillars, where would you like leverage to trend to? And to what degree in organic actions help you get there?

Ángel Vilá – *Chief Operating Officer*

Regarding convergent ARPU, which is EUR 91.5, grows 1.5% year-on-year in the second quarter, driven by the pricing update and fewer promotions, some other issues remain a drag as the lower out-of-bundle consumption, the growing O2 penetration and less advertising contribution.

If you compare it quarter-on-quarter, which I think was your question, the trend in Q2 is lower than in Q1 due to the more evident decline of out-of-bundle revenues, some mix erosion, but, it's the end of the football season. We see this every season when summer disconnections take place at the end of the season and most of the customers join again at the start of the season. We are aiming to see ARPU to continue having year-on-year growth in the second half.

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

On your question on leverage, as you know, we have a very strong public commitment to maintain an investment-grade credit rating. Deleveraging, as Jose Maria also said, remains a priority for us. Our main driver is going to be free cash-flow. Not only is very strong and will be very strong this year, but we also see a growing trajectory for the coming years. That's based on a steady organic OIBDA improvement and a CapEx peak being definitely behind us. You should expect free-cash flow to be the main source and also the most sustainable driver for deleverage.

It's also very important to mention that we prioritize the balance sheet strength with a very prudent debt management that has allowed us to be very resilient in the current environment. We have a very strong liquidity position and a light maturity profile. And we are anticipating much of the liability management, and we really tap the markets at the right moment.

On top of that, obviously, we will continue with a very strict capital allocation. And inorganically, we could also complement the deleveraging path because we have a top-quality asset base. But the main driver is going to be that resilient and recurrent free cash flow that you've seen in the past years, and it won't be the exception for the coming years either.

Georgios Ierodiaconou - *Citi*

My first question is on free cash flow. And I know probably a lot more details at you to be given at the CMD. But you did highlight the potential for growth going forward. Laura, you spoke about EBITDA and CapEx drivers. I was wondering if you can also give us a couple of insights as to how we should think about financial costs, which are coming down, even the rate is coming down, whether that is sustainable and what is behind it? Also, if you can come a bit about the recap in the U.K., which is a significant driver of your cash flow in 2023, whether that is something we should expect going forward? And any comments on working capital as well will be greatly appreciated.

And then my second question is about the U.K. market, and I know Lutz addressed this at conference call the other day around the churn for Virgin being lower than expected in broadband, given the scale of the price increases. Just curious to follow up, given now we have more data points from some of your main competitors, it does look like the market as a whole might be shrinking or the AltNets making more inroads perhaps on previous quarters. So just curious to hear your thoughts, which of the 2 explanations sounds more credible to you? And if it is a case of market growth stalling, whether there's any insights you can share on the timing of any recovery.

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

On free cash flow, indeed, in Q2, it has improved. It has grown year-on-year, almost doubling the Q1 figure. And this year is not an exception, free cash flow is usually back-end loaded, and we see free cash flow growth accelerating through the end of the year. OIBDA minus CapEx will be, according to our improved guidance, a main contributor.

And below that, we will continue optimizing every line as we always do. Working capital, which had a negative impact in the first half of the year will have a positive impact throughout the year and that is very much linked to our operational activity.

On financial payments, you should expect us to optimize it as we have done in the past. The cost "per se" is one of the KPIs to follow no doubt, but we also have to find a balance between currency, the life of the debt, the liquidity position, and the smooth path of maturity refinancing that we are always aiming for. You should expect us to keep on optimizing them as we have done in the past; we have 80% fixed, and what is variable is more in Hispam and Brazilian currencies, and that should start going down in terms of interest rates. We feel comfortable with the management we have at the moment and that being able to continue.

Regarding the U.K., no changes. We have guided the JV to stay at the upper-end of a 4 to 5 times net leverage range. It's a cash-generating business with organic and synergy-driven opportunities to grow. It has a strong current capital structure, the debt tenure is 6.5 years, excluding vendor finance, and the cost of that debt is 4.7%. It's not forced either to go into debt markets and to do so at inopportune times. It is going to have a growing OIBDA, which will lead to natural deleveraging.

So, as you know, that's going to be in-line with what we said at the beginning of the year. In the €4bn reference we gave for free cash flow in 2023, the cash distributed to shareholders is anticipated to be between £1.8 billion to £2.0 billion, and that's included in our outlook for the free cash flow we provided this morning.

Lutz Schüler - *Chief Executive Officer of Virgin Media O2*

On your question regarding the U.K. A year ago, we had a growth of 7,000 customers in Q2 after a price rise of 6% or 8%. This year, we have a price rise of 13.8%, so more than double of it and we are shrinking by 15,000. The delta is 22,000 between the 2 years while doubling the price rise. We attribute the delta to the significantly higher price rise, as you know, the impact of it, in our case, it has materialized entirely in Q2. Customers had a 30-day cancellation right, and this obviously is not the case anymore from Q3 onwards. Having said that, when you look at gross adds, I think your observation is right. The gross adds market is slightly smaller, but as I said in the Liberty Global call, we are actually doing better given we had expected a bit higher reaction on the price rise. All in all, we are pretty pleased with the overall number.

One last comment on Altnets, there are some areas where they are offering sales at very aggressive promotions. We see some of these impacts that our share on gross sales are lower in these markets, but we see it significantly less on churn. We think the reason for that is that the majority of our customers have more than one product, and as you know, then the convergence game is that people are not necessarily switching broadband if they don't have the right video product or mobile product.

David Wright – *BofA*

When we think about this free cash flow you are generating, a lot of it is borrowed, effectively from VMO2 with the borrowing cost of debt, as you've just said, Laura, the high 4s. I'm struggling to understand that contradiction with the need to delever, but borrowing at nearly 5% to 02 to support cash that you're paying out to investors? Does it not make more sense to reduce the leverage in O2 which is at a higher blended cost of debt? And also given that they arguably have a requirement to accelerate the CapEx to build fibre over time. It just seems like a contradiction to me that you're borrowing in the U.K. to pay out in Spain when you should be potentially looking to delever?

And then I guess, Lutz, I'm also not understanding your answer. I thought the data that you have given us is only the Q2 customer losses, but I think a lot of those price rises in the U.K., the announcements we made in May, so there will be more customer losses following in Q3 were they not? You said it was the full impact in Q2, but I think you'll probably get more customer losses in Q3 as that price rise is phased in, is that not the case, too?

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

On the U.K. and the impact in free cash flow, it is a part of our free cash flow, no doubt, but not a significant part. We are guiding on €4bn. This will be about €1bn. And you have seen the results of Germany or Brazil. We have very strong core assets generating very resilient and recurring free cash flow, that is, as I said at the beginning, and the main driver for deleveraging.

As you rightly mentioned, obviously, the agreement we have among the shareholders on the leverage range was done in a different scenario in terms of interest rates. So definitely, we will re-evaluate that. But it's worth mentioning that the capital structure of the JV is prudent in terms of life, in terms of cost, in terms of not going in a rush; we were successfully financing ourselves in the first part of the year at good cost in the current scenario. But that's something that within our strategic capital allocation decision and free cash flow drivers, we will evaluate going forward.

And more importantly, OIBDA is growing there, and they have a lot of synergies still as we haven't achieved the run rate yet. But we are in a very, very good trajectory and synergies are being delivered as expected. A very important thing is that from a leverage perspective, S&P and also Moody's look at that number as well, they account for the debt we have in the U.K. in proportionate basis. So, if we had a different mix between dividend and a less leveraged JV from a rating perspective, it will be very much neutral from Telefónica side. So, it is consistent, whether we continue with a 4 to 5 or we make any changes there, that should be agreed with our partner in the JV, but that will not affect our rating quality.

David Wright – *BofA*

If I may add, it just seems perhaps a little imbalanced because you are effectively keeping your borrowing at 5% and your blended cost is 3.5%. Liberty's objectives maybe are a little different because they are using the cash to buy back their shares, you're just paying out a dividend. It just feels that every time you're boosting your cash flow with the distribution, you are actually blending your cost of debt upwards because you're borrowing that cash at 5%?

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

Arithmetically, you are right. And that's why we will definitely take a look at this. But so far, the JV is delivering. So far, the JV is committed to the dividend we had for the year, and obviously, that will be evaluated.

But it was very important to mention that this is not the way to deleverage the company. We are not deleveraging the Telefónica side throughout the dividends from the JV. First, if we change the dynamic, we will have a less leveraged company from an S&P rating position, so we will be very neutral. And second, our core assets plus growing business units are delivering, and they are the bulk of the free cash flow of the Telefónica Group.

Lutz Schüler - *Chief Executive Officer of Virgin Media O2*

Sorry for the confusion, David. I think we have to distinguish a bit here; we have sent the price increase letters to customers in April and May. Customers do have then a 30-day extraordinary cancellation right. Therefore, all of this has happened in Q2.

Now, 60 days after the customer has received the price increase letter, the higher prices will be charged. with the exception of customers who are still in their promotion period. They get it then from the beginning of the promotion period, but they don't have another cancellation right when they are getting charged with higher prices.

Therefore, both actually fit very well together. The churn has materialized out of it into Q2, while the vast majority of the revenue is coming in across H2.

Mathieu Robillard – *Barclays*

I had a question about the copper switch off, which obviously you are leading in terms of that process in Europe. You have mentioned in the past that it could lift EBITDA margins by 1.8%, and I was wondering what would be the impact on CapEx? As a follow-up on the copper switch off, I realize that that means that you get your hands on a lot of copper and my understanding is that you're selling it. I wanted to understand how material that was in terms of the contribution to EBITDA for the Spanish on the group business? Then a very last one, when you talk about the free cash flow, excluding spectrum, getting close to €4bn I just want to clarify how we should compare that to consensus? I think the latest consensus you published was for €3.3 billion of free cash flow, so that would be materially higher, but my understanding is that consensus includes spectrum. I don't know if you can give a little bit of clarification here on what would be a like-for-like comparison?

Ángel Vilá – *Chief Operating Officer*

I'll take the first one on the copper switch off. As you said in the past, we have quantified that we have already captured an estimate of 0.8 percentage points in OIBDA margin from permanent efficiencies from copper decommissioning up to 2022. And we expect further improvements in the next few years, which we could quantify on at least an additional 1 percentage point on OIBDA.

You were asking then the question, what does this imply to CapEx? We have already clearly passed the CapEx peak in Spain; you have seen that the CapEx intensity of Spanish operation is well below the one in the group. And if you allow me not to “spoil” some of the messages of our new Capital Markets Day, we will then be quantifying the target of CapEx going forward, which will lead to this free cash flow growth that José María was highlighting in his speech.

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

On your free cash flow question, you are right when you mentioned the €3.3 billion, that is including spectrum, with the estimates that the market may have, which could be around €200 to €300m. That's the consensus figures on spectrum, I cannot disclose any of our own view on that.

If we exclude spectrum, consensus is more between €3.6bn to €3.7bn. So that's why we say we are extremely comfortable with that, and even we are going for the €4bn mark.

Regarding the spectrum that could come, part of it is already flowing because it derives from previous auctions, the main one in Germany that you already know the figures around that. Spain already happened, so certainty there, and it was at the reserve price. Uruguay already happened, and it's being paid only 25% this year, and it was also at reserve price. And then we have some uncertainty about the Ecuador concession renewal because of the political changes, it may be delayed. And also Argentina, there's the 3.5 GHz, but we are not sure if it will be end of this year or maybe a year from now. And in Colombia, we are asking for a very short period renewal on AWS linked to the agreement we are going to sign with Millicom, because we need less spectrum in that scenario.

On those that are still pending, I'm not sure that will happen in 2023. I remind you that in Hispam we are being very pragmatical and financially driven to spectrum, so that's going to be quite limited as well.

Going back to the first question, the €4bn mark compares with €3.6bn to 3.7€bn, so we will be well above the consensus.

Mathieu Robillard – *Barclays*

If I can come back to the question about the sale of copper, if that's materially in any way in terms of the contribution to the group OIBDA?

Ángel Vilá – *Chief Operating Officer*

The efficiencies from the copper switch-off and the sale mitigate expenditure effort of doing that. It's not significant in the numbers that we have been posting.

James Ratzer – *New Street Research*

I have two questions, please. The first one was, again, just coming back to the €4bn free cash flow figure, which undoubtedly is very strong, and just looking at the Q2 results it looks as if your infrastructure payments are quite low. My understanding is you're maybe generating now some interest on your cash balances. I was wondering if you could give us any more guidance on the sort of interest you are actually now receiving on your cash balances? And also, within the €4bn, you might have to pay in Peru on the tax and interest charges. To what extent is adding your €4bn figure?

The second question I had, please, was just regarding the European recovery fund. I mean if something Vodafone talks a bit more about in Spain than you do, but would just love to hear your thoughts on how you think that could potentially be a positive impact on your business and forward dividend?

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

On your question on free cash flow for the remainder of the year and financial payments. The financial debt-related costs, that has decreased versus the previous year, it's a combination of the mix of currencies and it's also that we are being, as you said, rewarded for our cash position. We are around Euribor and that's been part of that.

But as I said, the fact that we have a very resilient 80% fixed, plus the 20% variable has also contributed. This is also the result of our very prudent financing policy and liability management over the years. We are indeed being rewarded for the cash balances at market prices.

With regards to Peru, we had already some payments included in this first half of the year. And going forward, it could be the case, and we are considering that within our outlook of reaching the €4bn mark. But there's still a lot of uncertainty around that. We are waiting to hear from the tax authorities on the final amount and settlement indications. Some recent rulings are questioning the embedded interest charges in similar proceedings, that would be good news for us, but we still need to wait and see. We have our own estimates on this, and are also working on different payment alternatives, including fractioning of payments, and all of that is being embedded in our aim to reach that €4bn mark. I cannot be more precise on that because it's confidential, it's work in progress and we still have uncertainty around the different rulings and the actual payment dates.

Ángel Vilá – *Chief Operating Officer*

Regarding the European recovery funds, the non-refundable aids for Spain reach €77bn to be executed around 5 years with €20bn dedicated to digitalization. By the way, the period to execute is 2021 to 2026, so we still have significant horizon ahead of us. This focuses on 3 lines: public administration, SME digitalization and connectivity.

Telefónica is gradually securing a reasonable share of these funds in Public Administrations which could be in this period an opportunity of €5bn. We are getting a relevant share mainly in central administration projects, such as defense and economy ministries projects.

In SME digitalization, which is an opportunity along this period of around €5bn, the execution (and maybe this is what other competitors are talking about), the execution is a bit low to date. But we're already capturing on the digital kit projects, therefore capturing part of this opportunity.

The Connectivity opportunity, which is around €4bn in this period, these are direct subsidies to network investments in fibre, in 5G. We have already been awarded a significant amount, we are committed to extend the network deployment across the national territory. And then on 5G and mobile projects, there have been some limitations regarding high-risk vendors, which are not present in the Telefónica network. So those should be accessible to us and maybe they are not to some of the competitors that you were alluding to.

James Ratzer – *New Street Research*

Of the €20bn figure you mentioned for the whole project, how much of that has actually been allocated so far and how much is still to come by 2026?

Ángel Vilá – *Chief Operating Officer*

I don't have that number here, but I'm sure IR will be able to give it to you, sorry.

James Ratzer – *New Street Research*

No problem. But conceptually, it's still a relatively low number being allocated. There's still quite a bit more to come?

Ángel Vilá – *Chief Operating Officer*

Yes, and in particular in the SME digitalization, this has been the slowest to execute. There have been awards, but the execution of those awards is flowing slower. On the Connectivity side, the awards have been substantial already and in the Public Administration it continues ongoing. I would say that far more than 50% is still to come.