RESULTS
January - June 2021
Conference Call Transcript

29th July 2021

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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 2021 results. I am Adrián Zunzunegui, Global Director of 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

Q1 21 Results

1. Growth trend restored; 30% net debt reduction

Thank you Adrián. 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, CEO of Virgin Media-O2 JV. As usual, we will first walk you through the slides and then we will be happy to take any questions you may have.

The second quarter was crucial for Telefónica. We reached an inflection point in the transition to sustainable, profitable growth with organic revenue up and year-on-year trends accelerating for the fourth consecutive quarter. We posted our best ever net income after booking capital gains from the sale of Telxius towers and the creation of the Virgin Media O2 UK JV. Moreover, these capital gains have translated into a more efficient capital structure. And finally, they helped us reduce net financial debt by 30% year-on-year.

In parallel, our more efficient capital structure was reflected with our net debt denominated in Latam currencies increasing to 30% vs 21% as of March.

On the strategic front, we continued progressing on our objectives with key transactions closing in June and July. In the UK, one of our core markets, our position was reinforced as we created the national connectivity champion. Additionally, we continued to modulate exposure to Hispam; the InfraCo in Chile has been completed and we announced a new fibre vehicle in Colombia with KKR. Telefónica Tech has reinforced its capabilities in the Cloud space, with the acquisition of Cancom UK and Altostratus, whilst accelerating year-on-year growth trends. With regards to T. Infra, FiBrasil started operations in July after regulatory approvals were granted. All of this, with digitalisation gaining even more relevance and supporting our operating model and facilitating economic and social recovery.

Finally, ESG remains an important part of our strategy; we launched a new industry-wide Eco Rating scheme for mobile phones and have been nominated Europe's Climate Leader by the Financial Times.

2. Financial performance

Turning to slide 2, second quarter reported figures reflect the significant capital gains booked as we just mentioned, as well as other extraordinary effects. Reported figures also reflect changes in the consolidation perimeter, as Telefonica UK and Telxius towers were consolidated until May 31, and since then, the VMED O2 JV started to be consolidated using the equity method. They also reflect FX headwinds, which eased in the quarter. As such, the second quarter reported revenues narrowed the y-o-y decline by 3.6% to 10.0 billion euros and grew 3.4% organically, accelerating as much as 4.8 percentage points vs Q1, with all business lines contributing to this improvement.

Organic OIBDA also improved its annual growth rate to 3.3% in the second quarter year-on-year, whilst net income reached the 7.7 billion mark, and EPS reached 1.37 euros.

On its side FCF amounted to 877 million euros in the second quarter, and for the first half (excluding spectrum payments) it topped 1.6 billion euros, 31% more than a year ago.

Finally, net financial debt was reduced by as much as 11 billion euros in the last twelve months, to 26.2 billion euros, post distribution of Telxius minorities, as of June 2021. This is half the June 2016 net debt position.

3. Upgrading Revenues & OIBDA guidance

Moving to slide 3, we are upgrading our 2021 guidance for revenues and OIBDA. H1 21 performance is already meeting or slightly surpassing former FY guidance of revenue and OIBDA stabilisation.

And the outlook is positive for H2 in all our core geographies:

In Spain, efforts aimed at rationalising the competitive environment are starting to bear fruit and we are positive regarding H2 evolution. OIBDA margin, which has suffered from delayed roaming recovery is also expected to return to above 39% levels already in Q3.

In Brazil, strong commercial KPIs (record net adds in most segments), easing comparison base and the positive tariff update calendar makes us feel also positive about strong operational momentum being at least maintained.

In Germany, as our colleagues shared with you yesterday, FY guidance has also been upgraded as well on strong commercial and operational momentum.

Lastly, in Hispam we are seeing the commercial turnaround materialising, a top-line reversal happening in all countries, and whilst OIBDA is more volatile we are continuing to gain efficiencies.

As for CapEx, following H1 results where it stood at 13.4% over revenues, we maintain our up to 15% former guidance.

On shareholder remuneration, we paid the second tranche of our 2020 dividend last month through a voluntary scrip dividend, in which 71.5% of shareholders opted to receive new shares, further enhancing our financial flexibility as just around 300 million euros were paid in cash. As for the 2021 dividend, 0.15€/share will be payable in December 2021 and another 0.15€/share in June 2022, both through voluntary scrip dividend. Regarding treasury stock, the adoption of the corresponding corporate resolutions will be proposed to the AGM for the cancellation of the shares representing 0.7% of the share capital held as treasury stock.

4. Significant progress to achieve ESG objectives

During the second quarter, we further consolidated our commitment to sustainability across our three ESG pillars: helping society thrive, leading by example and building a greener future.

- In terms of **building a greener future**, we have launched an industry-wide Eco Rating scheme to identify the environmental impact of mobile phones. In addition, Virgin Media O2 has just issued its first green bond raising £1.3bn to support the fibre rollout and the use of renewable electricity. I would also like to highlight that Financial Times has nominated Telefónica as a Climate Leader.
- With respect to our **leading by example** pillar and in line with our commitment to creating a more equal society, we have updated our new Diversity and Inclusion Policy and announced a target of at least 33% of women in management positions by the end of 2024. Thanks to our progress we are one

of the best companies to work for women in Brazil (GPTW 2021) and we have reached a collective agreement with unions to adopt flexible working in Spain.

- And finally with regards to our contribution to **society**, Telefónica has not only extended its network connecting more people, but has also promoted education and employability to reduce the digital divide. For example, in April we opened a new 42 Campus – our 2nd free programming campus, with no age limit and open 24 hours 7 days per week. Also, in terms of offering new solutions for society, we have founded IndesIA, which aims to drive digitalization via Artificial Intelligence in Spain and have launched Vida V in Brazil, a health marketplace to make telemedicine more accessible.

All of the above contributes to the achievement of UN's Sustainable Development Goals, as can be seen in our new report "A sustainable world, a connected world".

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

Ángel Vilá – *Chief Operating Officer*

5. Spain | Back to revenue growth in a more rational market

Thank you José María.

On slide 5, we review the performance of our Spanish operation, which is turning around its revenues and showing annual growth for the first time since late 2019.

The market rationalisation that we have been promoting since Q4 20 is bearing fruit. Following a somewhat muted commercial activity over the last quarters, all accesses showed a month-on-month recovery throughout the quarter, with positive net adds in FBB in June.

The early ending of the football season had a negative impact on convergent ARPU. This impact, however, is expected to reverse in the coming months and we expect better ARPU in H2. Furthermore, convergent churn continues to come down and customer satisfaction has reached a new record highs (33 in June).

Revenues, hence, were back to growth in Q2, for the first time since Q4 19, thanks to improved trends in service and handset revenue helped also by solid IT, a partial recovery of roaming and the new portfolio. OIBDA trend also improved vs Q1, though it was less marked than in revenue, due to the lower margin of IT and handsets and the delay in full roaming recovery.

Looking forward, we anticipate margin improvement from the next quarter underpinned by better trading, improved ARPU and further positive roaming impact.

Finally, and in what we would call a very rational auction, we secured the spectrum needed in the 700MHz band at very favourable terms, which will help us to accelerate our 5G deployment and improve operating leverage.

6. Germany | Accelerating commercial performance

Moving to Germany on slide 6, where we have seen operational momentum accelerate in the quarter, with O2 ARPU now back to growth year-on-year in Q2. At the same time, we continue to get strong results in mobile network tests, and have 5G available in over 80 cities.

In May we also signed the NRA with 1&1 DRI – continuing our partnership and securing long term revenue streams.

In this quarter both revenue and OIBDA year-on-year trends have improved to +5.7% and +10.3% respectively, with capex growing by 6.9% year-on-year in the first half, continuing to ramp up through the year.

This has resulted in continued strong cash generation, with OIBDA-CapEx margin expanding by 1.0 percentage point in the first half of the year.

7. UK | JV completed, continued commercial traction

Moving to the UK on slide 7 where I'm delighted to say that the JV between O2 and Virgin Media completed on 1st June.

Since then, Virgin Media O2 has moved at pace to start integration, with senior leadership in place, B2B cross selling started and fast product development on the consumer side. During this time there has been continued commercial momentum and focus, with a total base of 54.6m (+ 7% y-o-y) on the back of solid base growth from across the Company.

Network rollout continues at pace, with 5G now live in almost 200 towns and cities, and project Lightning adding 89k new premises passed in Q2, helping to grow the Company's gigabit network to 7.2 million premises passed, and remaining on-track for completion of the gigabit upgrade by the end of 2021.

The JV has also reaffirmed its target to deliver annual synergies of £540 million by mid-2026 with NPV of 6.2 billion pounds.

To give an overview of the underlying performance, we have included the proforma results for Q2 here with:

- Revenue broadly stable year-on-year with improving trends in both fixed and mobile
- OIBDA +5.8% year-on-year on the back of continued cost control and commissions savings
- And delivering solid cash profitability with OIBDA-CapEx growing by 2.5% year-on-year in the first half of the year

8. UK | Network upgrade to full fibre

Moving to the next slide, as the UK's largest gigabit broadband provider today, we are taking the opportunity to bolster our long-term network strategy by upgrading to FTTP our fixed network of 14.3m cable premises after taking into account its existing 1.2m FTTP premises to full fibre to the premises, with completion in 2028.

We see a huge opportunity in the UK, with low fibre penetration (of c.20%) compared to Spain (c.80%), where we can utilise our fibre expertise, as well as creating options to potentially pursue the broadband wholesale market in the UK., together with other B2B and B2C opportunities.

Regulatory scheme in place is a plus, the time to invest is now.

By utilising the company's fully-ducted network, the upgrade will be one of the UK's most efficient fibre rollouts, costing ~£100 per premise passed vs ~£60 per premise for upgrade to a full DOCSIS 4.0 cable network – so a very modest increase in network cost during the upgrade, with no additional funding needed.

In addition, revenue benefits that are expected to accrue to Virgin Media O2's consumer, enterprise and wholesale businesses from the FTTP upgrade.

9. Brazil | Unique value proposition; revenue & OIBDA growth

Moving to Brasil on slide 9,

Vivo's unique value proposition resulted into sound access growth in the most valuable segments, namely contract and fibre connections. Transformation to a fibre company will be further boosted by FiBrasil which is already up and running, and will help us reaching our target of 24 million FTTH premises passed by 2024.

On the financial side, we posted very solid results, significantly accelerating growth trends in revenues to 3.2% year-on year in Q2. Better MSR and fixed revenues, that are close to stabilisation, explained the enhanced top line performance. This improvement at the top-line, along with efficiencies, drove OIBDA to return to positive growth at +3% year-on-year.

CapEx allocation continues to support cutting edge technologies that feed our top-line, with 83% of its total related to growth and transformation.

And finally, ESG commitments continue to expand, generating positive impact for all stakeholders. Thus, Vivo reached the 11th position in Merco's ranking of the most responsible companies during the pandemic in Brazil.

10. Infra | Fibre vehicles well on track, growth ahead

On slide 10 we show the progress of our fibre vehicles, which allow us to create growth opportunities and value, while accelerating deployment plans and addressing increasing demand for high quality ultrabroadband.

In Germany, UGG is progressing well in the roll-out of its network and has already connected the first municipalities. The first retail client was connected in June in record time, less than four months since the start of construction.

Additionally, both FiBrasil in Brazil and InfraCo in Chile received all necessary regulatory approvals with both companies already operational after their transactions completion at the beginning of July.

We have also announced a new fibre vehicle in Colombia, with KKR holding 60% of InfraCo and T. Colombia the remaining 40%. The company has a target of around 4.3 million premises passed in 3 years, with 1.2 million brownfield premises from T. Colombia contributed at a multiple of approximately 20x EV/OIBDA and a net debt reduction at Group level of approximately 0.2 billion euros. The closing is expected for Q1 22, after approvals.

We have a strong portfolio that gives us optionality. We will continue to focus on pursuing growth and value creation opportunities through our infrastructure assets and capabilities across our footprint.

11. Tech | Growth acceleration, increased scale

On slide 11, T. Tech revenue growth accelerated to +26.6% year-on-year to 203 million euros in Q2 on an increasing revenue base, and again, beating its market growth.

Tech services are driving the return to growth of the Group B2B revenues (+4.5% y-o-y in the April-June period).

In Cyber & Cloud, higher-value revenues like Managed Services, Professional services and Own/partners platform, which account for more than 50% of these revenues, continued to deliver double-digit growth. While in IoT & Big Data, IoT connectivity revenues, representing more than 50%, improved their growth rate to 8.1% in the first half y-o-y.

From a commercial perspective, we signed an agreement with TM ONE cybersecurity solutions for the Malaysian B2B and, and in Spain, we adapted our “Cloud Comms” portfolio to facilitate new ways of working and we reinforced our SMB offer. In this arena, we are proud to mention that we were awarded by Microsoft as the "Best Spanish Partner of the Year" in the "Digitalisation in SMEs" category for helping them maintain their business in the pandemic.

In Q2 we acquired Altostratus in the Cloud business and we incorporated Acens in Spain to the perimeter of T. Tech to continue reinforcing our professional capabilities.

Finally, T. Tech has just announced the acquisition of Cancom UK, reinforcing our position in the UK & Ireland with an end-to-end advanced cloud and security provider of significant size, relevant partnerships and highly skilled professionals serving customers from both private & public sectors.

I will now hand over to Laura for a review of our Hispam operations and the financial position.

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

Hispam | Accelerating growth while modulating exposure

Thank you Ángel, let's move to slide 12.

During the quarter we continued to modulate our exposure to the Hispam region, however accelerating growth and for the first time in 15 quarters we posted y-o-y revenues and OIBDA growth simultaneously in reported terms in Hispanoamérica.

On the commercial side, accesses increased year-on-year for all main products. In contract, all main markets posted positive net additions, while in FTTH net additions accelerated, driving a record performance for the Company in Q2.

In the fixed business, the new fibre vehicle announced in Colombia, together with InfraCo in Chile, is a clear example of our strategy to lower capital intensity, crystallise asset value while accelerating expansion plans.

Significant debt reduction on inorganic deals completion

On slide 13 we show how net debt has come down by €9bn or 26% since December 2020, thanks to the sale of Telxius towers and the VMED O2 UK JV, coupled with strong €910m FCF generation.

Net financial debt stood at €23.2bn as of June, or €26.2bn post estimated distribution of proceeds to Telxius minorities. Including post-closing events, net debt would be reduced to €25.8bn.

Net debt/OIBDA ratio went down to 2.57 times, that is, 0.2x below FY 20 ratio.

Our liquidity cushion amounts to €26.9bn and our average debt life has increased to 13.7 years, placing us in a very comfortable position as we have covered maturities beyond 2024.

Telefónica maintains a proactive and innovative approach to financing in 2021, raising 5.3 billion euros in total, including financing at the German fibre JV and the first green bond at the Virgin Media O2 JV.

We are evolving our financing strategy with increased weight of debt in Latam currencies as shown by the long-term financing raised in local currencies by our subsidiaries in Chile and Colombia. To note, Coltel signed two sustainability linked bilateral loans, being the first T. Hispam company to signed sustainability linked bilateral loans.

The effective cost of interest payments over the LTM stood at 2.69% as of June 2021 due to debt reduction in debt denominated in European currencies and its cost.

I will now hand back to José María to recap.

José María Álvarez-Pallete – *Chairman and CEO*

Wrap up

Thank you, Laura.

To recap, first, in the second quarter we completed two significant steps in our long-term sustainable growth strategy: the completion of the Virgin Media O2 JV in the UK and the sale of Telxius towers to ATC.

Second, our top line performance returned to growth while net income reached an all-time record level, with FCF excluding spectrum growing by more than 30% y-o-y.

Third, we continued to prioritise growth when it comes to CapEx allocation, with almost 50% devoted to NGN.

Fourth, we posted a significant net debt reduction, as much as 30% down y-o-y or 11 billion euros, mainly due to capital gains on strategic transactions, which improve the capital structure of the Group.

Finally, we are upgrading our FY guidance, to "stable to slight growth" at both the revenue and OIBDA level. Capex wise, we feel extremely comfortable by reiterating our up to 15% capex to sales target.

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

Q&A Session

David Wright – *BofA*

Thank you very much for the call this morning and a lot to digest. I guess the most significant announcement is the decision to move the U.K. business from cable to fibre. I see the price upgrades you've given the £100 per premise versus the £60 DOCSIS. So, can you just give us some more on your thinking? Is it the upload disadvantage ultimately that has driven the decision to choose fibre over cable? That is a very interesting development and I would very much welcome your thoughts.

And just secondly, on to Spain. I appreciate, I think, Ángel, you guided towards better ARPU dynamics in the second half. And you mentioned some dilutive effect in the Q2 number from football. If you could just expand on that the moving parts, please? That would be very useful.

Ángel Vilá – *Chief Operating Officer*

I will start with a response to the U.K. question, and then I will pass to Lutz. Today, we have announced that VM O2 has the intention to upgrade the fixed network to full FTTP by 2028. This will imply covering with fibre an additional 14.3m cable premises, because we already have 1.2m premises which are covered with fibre through Lightning. We from Telefónica have been clear supporters of fibre networks, all across our footprint. We already enjoy the largest fibre footprint in Europe by far. And we have been extremely supportive of the JV's proposal.

Lutz Schüler - *CEO of Virgin Media-O2*

We have a very unique situation in U.K. We have a deep fibre fully deducted network. And that brings us in the position that we can upgrade our network to FTTP at very low cost. And this is referring to the £100.

Now, we have the comparison with DOCSIS 4.0. So, based on DOCSIS 3.1, today we already have 1.1Gbs speed available. We can upgrade DOCSIS 3.1 to above 2Gbs per second. And then after that, we have taken the decision not to go for DOCSIS 4.0, but instead to go for FTTP.

This is clearly an offensive move because we see a lot of business opportunity coming with it. Think about the wholesale market in U.K., think about the B2B market and also better competitive position in the consumer market.

Ángel Vilá – *Chief Operating Officer*

You were asking about the second quarter ARPU evolution and what would be the outlook for the second half of the year.

We have experienced an ARPU decrease in the second quarter. And the main drivers of that evolution are the following:

- The first one is the ending of the football season that leads to some of our customers to downgrade temporarily. This will be an effect that will reverse in Q3 and of course, in Q4 when the next football season starts.
- Also, there is a continuing impact as we have seen in previous quarters of increasing no-frills options' penetration. Customers taking the O_2 or the "Movistar Conecta Max", which is pure connectivity without content.
- We also have had lower "out of the bundle" consumption and some promotions ending at the beginning of the quarter. This ending of promotion intensity will be much lower in the quarters going forward because we have been far less active in promotional activity.
- At the same time, the new Fusión portfolio, that has a more-for-more, was applied at the end of the second quarter, while we have had March 2020 tariff upgrade. So, this impact in Q2 would not be recurrent in the following quarters.
- So, the new "Fusión"portfolio of has still not been relevant in Q2, although it will kick in in Q3 and so on.

So, the outlook for ARPU on the second half, starting Q3, we expect ARPU to reflect the reversal of some of these seasonal effects. And we also will have higher revenues from new digital services that are gaining traction. Therefore, we expect a higher ARPU for the second half than what we've seen in the first half.

David Wright – *BofA*

And Ángel, if I could just follow up, I guess the football downgrades, that should be annual though that happens every year does it not? And you mentioned the tough comp on pricing. I assume it's difficult now to envisage price increases with the current competitive pressures. And the obvious question is maybe the margin doors need to step down now. Is that correct with the digital services running a lower profitability?

Ángel Vilá – *Chief Operating Officer*

Well, regarding the football end of season, you would have to compare with 2019 to get a similar effect, because in 2020 the competition was halted. So, we didn't have the same impact a year ago which we are experiencing now.

Regarding price increases, we are seeing price increases from competitors. Vodafone and Euskaltel are increasing prices now in July. Orange has announced price increases in August. So that is happening in the market.

And regarding margin, what we have seen this quarter is reactivation of some of the commercial activity, but we still do not have full recovery of roaming. In the second quarter roaming is at levels, depending on the geographies, of between 1/3 and 40% of what would be the normal roaming levels compared, for instance, to Q2 19. So, we're still suffering the impact of roaming still not reactivating fully yet.

We also have a reactivation of handset sales, which come with lower margins and IT. That has put pressure on our margin. But for the second half, we will be not far from the 40% levels because we expect some further roaming reactivation, which is margin accretive, and we will continue having efficiencies in commercial costs. So, for the second half, you should see, and we are expecting margin recovery, at least 1p.p. higher than what we saw in Q2, and we should be not far from the 40% levels.

Georgios Ierodiaconou - *Citi*

I have two follow-ups to the previous questions asked by David. The first one around the decision to go for fibre. You mentioned the opportunity on the wholesale market. I'm just curious what was preventing doing some kind of agreement with cable on wholesale? Is it the demand on the other side? Or is it logistically allow users to do that with fibre?

And if I could perhaps ask a question whether that also makes it easier for you to find partners to fund the upgrade to fibre? Whether that's something you may be considering in parallel to what you already announced?

And then my second question is Spain, thank you for going through the moving parts, I think it's quite clear. Some of the things are happening under your control. But if you could also comment, you mentioned that the price increases announced by your competitors. If I'm not mistaken, in Spain they notified the customers a bit earlier. How much of the benefit was already in the June numbers you have shown on slide 5? And how much of it do you think will be across to the third quarter? So, should we expect that you move into positive territory now that your competitors have done more for more?

Lutz Schüler - *CEO of Virgin Media-O2*

When you think about the wholesale market, it's very simple. More short and midterm, we can offer a possible wholesale partner the faster speed onto our cable network. Today, 1Gbs, in the near future, 2.2Gbs. And then, in the longer term, we have all the speed possible available, higher than 10Gbs upload and download. So this puts us in a very strong future-proofed position in potential negotiations.

And the partner approach is completely independent from that. So we haven't announced any acceleration on Lightning. So obviously, we are pursuing possibilities there.

The announcement today to upgrade on to fibre takes into account the unique position in the U.K.. At very low cost, you get to a fully-fledged fibre network. And that, in the long term, puts us in a very strong position.

Ángel Vilá – *Chief Operating Officer*

Regarding the second question on Spain. I think we have to envelop everything that's happening into a more rational market.

We have been working in driving rationality in the market by cooling it down. This has had benefits in terms of our churn. Also, fostering quality has improved our NPS.

The market is behaving more rationally; what we have seen is that promotions have gone to half of what they used to be. Even the early summer promotions, the different players are offering, for instance, for second residences, are softer, with a more rational behaviour. These “more-for-more” that we are seeing from our competitors are a sign of rationality. All operators have joined forces to stop regular practices for acquiring subscribers. The regulator has been promoting a spectrum auction with conditions, which are pro investment. And we have seen rational behaviour in that auction as well.

So, we think that there are evident signs of rationalisation from most players in the market. And this is leading to these dynamics that I was describing before with respect to outlook for ARPU, and also in the commercial traction that we are seeing within the quarter.

Georgios Ierodiaconou - *Citi*

Yes. If I could ask a follow-up on the fibre question. I'm just curious to understand, you mentioned that finding a financial partner is independent from the decision today. I just wanted to understand two things. Firstly, whether financial partner is more leaning towards Project Lightning itself? Or whether it could include some of the existing infrastructure?

And is it fair for me to assume that it makes sense for you to announce wholesale deals before you find a financial partner because, obviously, in that way the price is better?

Lutz Schüler - *CEO of Virgin Media-O2*

I would say everything is possible. And also every order is possible, is the simple answer. We have different plans. We are in different conversations. It's too early to tell. Sorry to be not more concrete, but we're actually in the middle of it.

Jakob Bluestone – *Credit Suisse*

I've got one question, please, on Spain. You referenced Spanish OIBDA, which sort of fell fairly similarly to what we saw during Q1. And I was just wondering if you could comment specifically around the outlook for OIBDA in Spain? When do you think the rate of growth might improve? You obviously mentioned that ARPU growth or consumer ARPU growth should improve in the second half. but I think that only makes up about sort of 1/3 of your service revenues and there's other stuff in there as well. So could you maybe comment specifically on what is the outlook for OIBDA in Spain? Do you think the growth rate will improve in the coming quarters?

Ángel Vilá – *Chief Operating Officer*

The trend of OIBDA in Q2 improved versus Q1 slightly, but improved, thanks to improved service revenues, and despite a worse year-on-year comparison versus what was a very atypical Q2 in 2020, because last year we had very low commercial and production costs and some non-recurring factors. So, the trend has improved, but the comparison was tough versus 1 year ago, that was very atypical.

This improvement was lower than the revenues improvement because of the lower margin of some of the revenue growth levers, namely handset sales and IT. And as I was saying before, the slow reactivation of roaming.

We believe that from Q3 onwards, the football seasonality will revert, improving the ARPU and therefore, flowing into profitability, and also recovery of roaming, which may add, in our estimates, around 1p.p. to margin. And this would, of course, improve the trends for the second half.

One thing that I would like to note is that in the third quarter, there will be a difficult year-on-year comparison related to content costs because one year ago, we got some rebates from content suppliers to us because certain sports events were cancelled. And this helped the OIBDA in the third quarter 2020, and that is not a recurring factor in 2021.

So, all in all, we believe that the margin is going back to close to 40%. The year-on-year comparison in the second half will improve, but in the third quarter, we'll be adversely affected by these non-recurrent content rebates we had one year ago.

Keval Khiroya – *Deutsche Bank*

I've got two questions, please. So firstly, can you update us on where you stand on the potential of further inorganic options in Hispam? And do you think it will now be easier to strike potential deals now that hopefully most of the COVID drags are behind us?

And then secondly, following on from the previous questions on Spanish OpEx. You will obviously have this continued mix shift towards more digital services. And as you look beyond 2021, do you think any areas where you can actually accelerate the level of cost reduction to then help the overall impact on the margins beyond this year?

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

Going to Hispam, our aim is not to do deals, but to modulate our exposure as we focus on profitability, efficiencies and extracting more value from our assets. I think that we have found a nice formula with the FibreCos, which are allowing us to accelerate deployment, which, in turn is enabling us to capture the fixed broadband growth in those countries. And at the same time, we are monetising the brownfield and the contracts. The FibreCo in Chile, the FibreCo in Colombia together with the very soon expected approval of Costa Rica are going to contribute to net debt reduction of €1bn. But that's not the ultimate goal, as I said. We are modulating and improving return on capital in different fronts. Our role is to take care of the operations.

As I mentioned, we have delivered very strong results. Revenue and OIBDA improved by 9.5% and 0.3% organically. And in terms of commercial KPIs, they are very, very solid. New contract accesses are over 1.1m in the first half of the year. Fibre is growing very well, booming, with almost 0.5m new connections. All of that is being fuelled by a new operating model. A new operational model, much more mutualised, which is going to bring very nice savings and at the same time, it's giving us a lot of agility. We are already operating under this model, and the FibreCo in Colombia deal was run by a true regional team, doing it in a very short period of time, as you have seen since we closed the previous deal in Chile. We are also going to work along that line in the case of Peru.

As you have seen also in the debt explanation, we are reducing the equity exposure substantially. We have net debt in Chile, Peru and Colombia, very much aligned to the group ratio, at around 3x. And we've been active throughout the first half year. We've been issuing in Chile and in Colombia. We are preparing financing in Uruguay, that is going to take net debt in Uruguay to almost 2x OIBDA.

We are doing this with a very asset light model. So very low capital is being devoted to the region. We are not detracting neither management focus from the group nor financial resources. Hispam is becoming an optionality and a potential for value creation as it's been proved already in the financials. And as COVID headwinds ease, I think that's going to be even better.

José María Álvarez-Pallete – *Chairman and CEO*

This is the first quarter in the last 15 quarters that Hispam revenue growth in euros in reported terms and also in OIBDA. So, I think that also the operational performance of the Hispam unit is helping us to allocate in a different manner our capital structure. So please note that there is a turnaround in euro reported terms in both revenues and OIBDA.

Ángel Vilá – *Chief Operating Officer*

And regarding your question on direction of travel of OpEx. Not only looking at the rest of the year, but going forward towards next year, the main cost buckets of our Spanish operation are personnel cost, content cost, then we have cost of goods, supply costs related to IT, commercial costs and other expenses.

The direction of travel of these different elements, not when one looks at the next quarter, or the next quarter after that, but into the years to come:

- Personnel cost, as you have seen we are continually working for efficiencies with respect to personnel cost.
- The second bucket, content costs. We are going to start seeing new cycles of sports where we have acquired, or we plan to acquire content with deflation. So, for instance, from September this year, the new UEFA Champions League kicks in where we achieved a 16% reduction in the cost in the last auction. And of course, LaLiga will be one year after, and the auction still has to take place, but our aim is to go for deflation. These two lines should go in the direction of being more efficient cost-wise.
- On supply costs or cost of goods sold for either our IT activity or the handsets, which are implicit in our new Fusion portfolio, will be aligned with the evolution of those revenue lines because those are directly linked to the cost of sale.
- Commercial costs, in general, should keep the same weight as they have now.
- And other expenses like network savings, efficiencies from legacy switch-off, bad debt and so on, we expect to continue to decline as has been the case up to now, at a significant rate.

So, this should be the direction of travel of our cost function in the Spanish operation.

Nick Delfas – *Redburn*

Question for Lutz. Of £100 upgrades figures quite eye-catching, obviously, for those of us who live in the U.K. calling a plumber tends to cost that much. Have you really tested that in a wide range of situations to understand whether that's the real cost? And then what's your cost to connect on top of that?

Lutz Schüler - *CEO of Virgin Media-O2*

Yes, we have done pilots already. As we speak, we are doing a bigger pilot with 50k premises. So the technical team is very confident to meet that number. As I said before, the reason that is that we already have deep fibre everywhere in our network, and then we have proper ducts. So it's what we have found so far and what we have all documented is that £100 per premises is achievable. This compares to £60 per premises that we have tested if we went for DOCSIS 4.0. It's simply a great situation for the U.K.

Nick Delfas – *Redburn*

Well, that gets you past the home, so what's going to be the cost?

Lutz Schüler - *CEO of Virgin Media-O2*

Yes, the connected cost. So we haven't disclosed that yet. I've seen that you made an estimate, already. You're broadly not so wrong with that estimate.

We have to test that again, we have to pull fibre then entirely into the home and the customer obviously needs a new CPE. The good thing is that we can do this entirely demand-driven. What I mean with that is that if a customer gets on to DOCSIS 3.1 today, the customer can get up to 2.2Gbs speed, and fibre then kicks in for higher speed. So therefore, we get to a fibre network at very low cost very quickly. And then the migration costs are linked to a customer migrating to higher speeds than 2.2Gbs. And this obviously also can come with additional revenue. So therefore, I think to call out costs independent of top line is not appropriate at the moment.

Nick Delfas – *Redburn*

So you'd have a connection fee of maybe £300 plus for an incremental connection if someone wants?

Lutz Schüler - *CEO of Virgin Media-O2*

Maybe not connections fee. You've seen the new wholesale regime in U.K and it seems that the first time in the country, we are able to monetise higher speeds.

Today, the average speed of the VMO2 customer is 2.5x faster than the average of the country. So, we talk about now a business model that kicks in for an average speed above 2.2Gb So I think either the monthly subscription will be higher, a combination of installation costs and monthly will be higher whatever. It's still early days, stay tuned.

Nick Delfas – *Redburn*

So, you have a large connection fee, but you're going to have to pay for that for the incremental ARPU from a customer wanting 10Gbs versus 1Gbs?

Lutz Schüler - *CEO of Virgin Media-O2*

Exactly, we can choose what we are going to do between installation cost and connection costs.

Carl Murdock Smith - *Bernenberg*

I just wanted to ask a slightly longer-dated question. I recognise it's more of a Board decision than necessarily for you. But just beyond this year, what are your thoughts regarding the voluntary scrip option? You obviously seem quite confident in terms of the future. You seem to think that your shares are cheap. So why are you happy to see the share counts continue to increase? And now that the net debt is much reduced following the M&A, should we be thinking that the voluntary scrip option won't continue into future years?

José María Álvarez-Pallete – *Chairman and CEO*

As you know, what we have tried is to provide flexibility to our remuneration policy. Especially in uncertain times like this year because of the COVID outcome and also because of several spectrum auctions that we had on top of the table (now two of them are cleared). In terms of the acceptance of our shareholders to this proposal, 71% came for shares in the last and therefore, they were somehow protected by the dilution. And we are trying to devote any excess free cash flow that we have in order to try to mitigate the dilution impact of the scrip option. We have cancelled 1.5% of treasury stock in the last shareholders meeting. And today, we are proposing an additional cancellation of 0.7%.

So, for the time being, we will provide this flexibility. And you know that we have committed for the tranche coming in December for the 2021 dividend. And the second tranche will be approved by the next shareholders' meeting, and we will update you there. We don't have a specific proposal to share. For the time being, we really appreciate this flexibility that allows us to keep investing into growth CapEx. But yes, you're right, we are approaching the time in which debt levels are much more sustainable and in which underlying EPS is back to better trends. So, we will be reassessing the position in the next year-end results.

Thank you very much, and we 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. Thank you.