Telefónica January-December 2011 Results Conference Call Transcript

24th February, 2012

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Introduction

María García-Legaz - *Telefónica S.A. - Head of IR*

Good afternoon, ladies and gentlemen, and welcome to Telefónica's conference call to discuss January-December 2011 results. I am María García-Legaz, Head of Investor Relations. Before proceeding, let me mention that this document contains financial information that has been prepared under international financial reporting standards. 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 by dialing the following telephone number, +34-91-482-8700. Now let me turn the call over to our Chairman and CEO, Mr. Cesar Alierta, who will be leading this conference call.

Presentation

Cesar Alierta Izuel- *Telefónica S.A. -Executive Chairman and CEO*

Thank you María.

Good afternoon ladies and gentlemen and welcome to Telefónica's 2011 results conference call. It is my pleasure to chair this call.

Today with me are the members of the Executive Committee, so during the Q&A session they will have the opportunity to answer the questions you may have.

2011, a year of record FCF generation and significant progress globally and vertically

Let me start with the highlights of the year 2011. It has been a year of significant progress for the Group, not only globally but also vertically.

First, we have reinforced our franchise in Latin America, a region which already accounts for over 45% of our results. We have strengthened our leadership in Brazil, the key market in the region and our main growth engine.

Second, we have surpassed the 300 million accesses mark, further increasing our scale.

Third, we have led the MBB adoption across our footprint, a key cornerstone of our growth strategy.

Fourth, we have reinforced our value chain, expanding vertically and increasing our scope through Telefónica Digital.

Fifth, we have continued building competitive advantages, with significant investments in MBB, UBB and spectrum.

Sixth, we have strengthened our liquidity position.

On top of that we have posted a solid set of results. We have delivered top line growth, retained industry leading profitability, and met operating guidance, despite worse than expected trading conditions.

And, finally, we have delivered leading cash returns for our shareholders.

Record yearly FCF generation

As you can see on the next slide, all these milestones have been achieved while reaching best-ever FCF generation level.

We are clearly outperforming our peers.

We are the most geographically diversified integrated player in the telco industry, and despite market concerns, we have the lowest exposure to European markets among our peers.

Our unique diversification and an active financial management have been key to post this strong performance, despite higher levels of investment to bolster future growth.

New strategic boost from last summer to drive transformation and increase our growth potential

Moving to slide 7, I am particularly proud of the new strategic boost implemented from last summer to accelerate the company's transformation journey and to increase our growth potential.

In the last 6 months we have speeded up the optimization of our asset base, reaching several agreements with third parties and selling non-core assets.

We have also taken decisive actions on the commercial side to regain momentum across our markets.

Moreover, we have set a new remuneration target which allows us to maintain a very competitive remuneration while increasing financial flexibility.

Finally, and key for the future of Telefónica, we have implemented a new organization that will allow us to speed our execution in the digital world and to fully exploit all the benefits of our scale through the recently created global units Telefónica Digital and Telefónica Global Resources.

Strong investments in customer expansion, setting stage for future growth

Slide 8 shows that the commercial repositioning just mentioned is already showing very positive results.

We recorded a strong acceleration in net adds in the second half of the year, specially in mobile, driven by record smartphone sales and the solid increase in the contract segment, which already accounts for one third of our mobile base. Q4 figures were particularly strong, leveraging the Xmas campaign.

We have invested to bring enhanced propositions to our customers, efforts that have allowed us to grow our customer base by 7% year-on-year, setting the basis for future revenue expansion

Delivering growth from data on rapid adoption of MBB

On the mobile data business, a key strategic area for Telefónica, we are posting very strong results.

We are leading data adoption and monetisation in our markets, allowing a very fast expansion of MBB penetration across our footprint, with levels around 30% in Europe and a huge potential ahead of us in Latin America.

Data revenues continue to deliver an outstanding growth, and already account for 31% of mobile service revenues, and over 40% in the case of T. Europe.

Non-SMS data revenues were very strong, up close to 40% year-on-year, to account for 52% of total data revenues.

Again, we are outperforming main competitors in this market.

Monetising the MBB explosion

Please turn to slide number 10 to get more colour on how we are monetising the MBB explosion.

First, we are mainly focused on smartphones. In Europe, over 90% of handsets sales on the contract consumer segment in Q4 were smartphones and the penetration in the prepaid segment is still very low. This is clearly an opportunity ahead of us, as everyday there is a wider portfolio of handsets at cheaper prices.

Our pricing strategy, based on tiered pricing across our footprint along with integrated tariffs in Europe is leading to positive signs of profitable data monetisation. Let me stress that all our smartphones have a data rate attached, and therefore are active users of the service, with an average uplift in ARPU of 1.5x in the case of regular contract customers.

The profitability of a smartphone vs. a regular contract customer is 1.4 times higher. This figure varies across countries, depending on local subsidies, improving along the time, as we leverage lower handset prices, lower commissions and we control network costs with our limited tariff plans.

The strategy is working, with traffic growth decelerating and converging with the revenue growth, which is accelerating and growing very nicely. I would like to draw your attention to the case of T. Germany, a good example of successful data monetisation, where non-SMS data revenue is growing 47% and traffic 32%.

Building on our strengths to successfully execute our growth strategy in 2012

Looking into 2012, we will build on our strengths to execute our growth strategy. Thanks to our healthy expansion in the last years to increase diversification, we are now in a better shape to succeed.

Trading conditions in Europe are difficult, but close to 50% of our sales already come from other geographies, and as I said before, we have the lowest exposure to European markets among our peers. Moreover, Latin America continues to grow very strongly, and the structural growth potential in the region remains intact. We are in a very unique position to capture this growth opportunity.

Despite regulatory noise, our net exposure to mobile termination rates and roaming in Europe is very limited.

We are in an industry where scale is a must and Telefónica's global franchise cannot be replicated. Being number 1 or number 2 in most markets is key to deliver profitable growth, and we have already built these local competitive advantages in key markets.

Traditional revenues are under pressure, but we have rapidly increased the contribution of mobile data to our sales and we are taking the right actions to profitably monetise the MBB boom.

Telefónica Digital will be key in this area.

Telefónica Digital, our platform to monetise the opportunity in the digital world

Turning to next slide, in a changing digital environment, we have already the right platform to monetise this opportunity based on very solid foundations.

First, we have 307 million billing relationships on a global IP multi-access network.

Second, our strength in enterprise and government market segments places us in a very good position to exploit changing value chains.

Third, we have a timing advantage over competitors, with 18 months experience on Digital Services Development through the "Verticals" and the unique experience we have in UK, the most European advanced digital market.

And fourth, the huge cross-sell opportunity arising from managing existing customer relationships, from basic access to media portals, like Terra, to more complicated social interactions, as Tuenti, and even client-to-client customer service as Giff-Gaff.

This unique combination of assets and capabilities is already driving growth from new digital services while fostering transformation of our core business, and we are already seen as the best partner for emerging digital players, given our unique combined position in Europe and Latin America.

Best in class networks place us in the best position to maximize value across the whole value chain

In the current digital environment, a global, open and scalable network becomes the major differentiator in the whole value chain, as it complements our digital assets with a unique combination of high speed connectivity with computing and storage capabilities that will help us to outperform in the digital world. A complete set of assets, including physical elements and intangibles such as spectrum and unique telephony address space, are key to guarantee end-to-end control and quality of services. As an example, we are already providing differential content delivery services, especially fit for video, and also innovating on digital communication services for end users, offering a single and ubiquitous customer experience on a variety of access technologies, including Fiber to the Home and LTE.

Let me now put some numbers in context:

We have invested 31 bn euros in the last four years; our full IP core network adds up to 5 million Km of terrestrial fiber, connecting more than 100 thousand servers, with capacity to transfer more than 2 Terabit per second (equivalent to 250 video CDs per second!). Wireless accesses are supported by more than 100 thousand base stations and we are offering fiber to end customers in 6 of 9 main markets, where 50% mobile base stations are already connected. We have a strong R&D franchise, with more than 1 thousand engineers developing digital services for Telefónica, including open interface to more than 10 thousand external developers. In addition, technology innovation is reflected in the close to 100 patents registered annually; half of them being part of actual products & services.

In 2012 we will further advance in our transformation journey, prioritising investments to drive forward growth

In 2012 our first priority is to foster revenue growth, leveraging further commercial momentum, with focus on fixed and mobile broadband as key levers for accesses growth. The launch of Telefónica Digital will further push our revenues up.

We will execute a tight control of non-commercial costs to extract efficiency gains to balance growth and profitability, amid increased customer investment, to support top line expansion and improve market share, capitalising on scale benefits through Telefónica Global Resources and taking advantage of integration and restructuring plans to maximise in-country efficiency.

We will continue strengthening our networks, with focused investments in broadband to improve networks capabilities, including a selective deployment on fiber and LTE where appropriate and depending on regulation.

This strategy will be compatible with maintaining a very attractive and sustainable shareholder remuneration policy and lower debt levels.

In 2012 total shareholders' remuneration will amount to 1.50 euros per share, including the payment of a cash dividend of 1.30 euros per share and a share buyback for the remaining amount. And we expect to reduce our leverage ratio below 2.35x net debt to OIBDA.

Regarding the operating guidance, we expect revenues to grow above 1% in 2012 at current exchange rates. We will continue to deliver solid profitability, with an OIBDA margin decline lower than in 2011, and CapEx to sales ratio will be similar to 2011 figure.

A very attractive shareholder remuneration fully covered by FCF generation

As you can see on slide 15, FCF generation comfortably exceeds expected outflows linked with dividends and share buy backs. In 2011 FCF per share was 2.06€ and our remuneration targets for coming years are around 1.5€ per share, so there is a very ample room.

And we have the leading dividend yield, not only in the sector but among the top largest companies by market cap worldwide. (I am sure that this anomaly will reverse, and the correction will not come from the numerator but from the stock price).

Let me now hand the call over to Angel.

2011 Key financials

Thank you César.

Please turn now to slide number 17 to start with a detailed review of 2011 results.
In the second half of both 2010 and 2011, we booked several very significant extraordinary items. So, to better understand the underlying performance of the Company we are providing a P&L excluding those non-recurrent effects and non-cash impacts.

As such, revenue reached 62.8 billion euros in 2011, growing by almost 5% excluding regulation.

Underlying OIBDA totaled 22.7 billion euros, down about 1% ex-MTRs, despite increased commercial activity. Net income totaled almost 7.5 billion euros, resulting in an underlying EPS of 1.66 euros.

2011 Organic evolution

Slide number 18 reviews Telefónica's organic performance.

On this basis, revenue growth excluding MTRs was 1.4% while OIBDA margin posted a year-on-year decline of 2 percentage points.

CapEx excluding spectrum was below 9 billion euros.

So, revenue, OIBDA margin and CapEx performed in line with our full year targets, resulting in an organic OpCF figure of close to €14 billion.

Best portfolio diversification drives revenue growth

As slide 19 outlines, Latin America continues its progression as the key engine to revenue growth, and more than offsets lower sales from our European businesses, accounting for almost half of total revenues, up 4 percentage points, thanks to the higher contribution of Brazil.

In terms of OIBDA, Brazil will soon account for about one fourth of consolidated figures, with T. Latam already representing 48% of the Group's OIBDA.

Industry leading profitability

Moving to slide 20, in 2011 we posted a healthy 36.1% organic OIBDA margin, which remains as a benchmark among our peers.

This profitability level reflects a strong cost control and benefits from our scale amid strong commercial activity, record smartphones sales and increased network & IT expenses mainly related with the roll-out of our MBB networks and enhanced customer care.

Strong CapEx to deliver long-term growth

In 2011 we have also invested heavily to support long-term growth.

Total CapEx excluding spectrum was roughly 9 bn euros, with growth across most businesses, being Latin America and Spain the main contributors to year-on-year organic growth.

CapEx to sales stood at 14%, slightly higher than in 2010 and in line with our peers.

On top of that, we invested 1.3 bn euros to reinforce our network through spectrum acquisition in several geographies.

As a result of these and past efforts, we can affirm that we are not underinvesting in the business.

Strong FCF allows for debt reduction

Turning to slide 22, let me highlight that in 2011 our strong FCF generation could allow us to reduce net debt by 1.6 Bn euros, pre-discretionary & non-cash items. Financial investments, comprising the purchase of Telefónica, Vivo and China Unicom shares, led to a net debt increase of 1.3% by year end.

Since year closing, we have materialised significant debt reduction actions. Agreement has been reached for Colombian restructuring, and some minority stakes have been divested. As a result, net debt would be down by 1.5 bn euros vs. December 2011.

Net financial debt to OIBDA stood at 2.46 times or at 2.63 times when including commitments and excluding assets sales. Once post-closing events are considered, net financial debt to OIBDA stands at around 2.4 times.

Please notice that with the share purchases already included in our debt balance at year end, the cash outflow for the next interim dividend payment should be significantly lower, since up to 30 cents of the next dividend distribution could be in kind.

Active financial management to minimise cost and maximise cash preservation

Furthermore, our active financial management has been key to minimise debt cost and maximise cash preservation.

First, effective interest cost of our debt stood at 4.91%, 9 bps lower than in 2010 on a comparable basis, in spite of current debt market conditions.

Second, we have demonstrated our cash upstream capabilities, with record cash repatriation from Latin America, exceeding the 3.3 bn euros mark in 2011.

Third, our working capital management has led to further cash available, over 1.35 billion euros cash generation, while an appropriate tax policy has resulted in a 5 p.p. cash tax rate reduction versus 2010. In both cases, we are beating the guidance.

Strong liquidity position, proactive refinancing

I would now like to highlight our strong liquidity position.

At year-end we held 5.1 bn euros cash position, excluding the cash in Venezuela. On top of this, in 2011 we renewed and increased by 1 bn euros our undrawn committed credit lines, so that at year end we had over 10.1 bn euros available. 76% of those credit lines are long term. Year to date we have additionally extended approximately 0.6 bn euros undrawn lines to 2014 & 2015.

Amid demanding credit markets, we raised around 11.5 billion euros during 2011, maintaining a balanced approach to the credit markets and diversifying our funding sources. First, by getting continued support from banks. Secondly, by our successful access to the bond markets and third, by benefiting from other alternative funding sources such as multilaterals facilities, exports credit agencies or local markets financing.

In addition, in the first two months of 2012 we have also been very active and have made strong refinancing progress. Year to date, financing activity amounts to 2 bn euro with a 10 Bn euros orderbook on our recent bond issuance. The syndicated refinancing is in very advanced stage and will be closed very shortly. This, together with the preferred shares, which are extendable to perpetuity at our discretion, allow us to say that 2012 maturities are substantially refinanced.

2012 outlook: Increase financial flexibility, maximise value

Looking into 2012, we have as financial priorities to increase balance sheet flexibility and to maximise shareholder value.

We will continue working to progressively reduce the leverage ratio and to protect our rating.

We will continue to be opportunistic and to proactively refinance our debt looking beyond 2012.

We will maintain M&A discipline, with focus on an active portfolio management, as shown by the progress made so far in restructuring the Colombian operations and divesting non-core stakes.

We will further execute strict working capital and tax management measures to maximise cash-flow generation, and we expect again to beat cash tax guidance.
And all these will strengthen our position to deliver premium returns and value to our shareholders.

Latam: Solid operating momentum heading into 2012

Let me now focus on the performance of our businesses by region, starting with Latin America.

2011 has been a year of very solid growth in the region. And the strong performance recorded on the commercial side, specially in the second half of the year, has led to a healthy expansion of 10% in our customer base. Particularly strong was the momentum in mobile, with net adds growing by 66% year-on-year in the fourth quarter, to reach 7.5 million.

Our targeted actions on high value customers have led Telefónica to reach the largest contract base in the region and to lead the MBB adoption in Latin America.

It is important to highlight that increased customer spend is flowing into revenues, leading to an acceleration in revenue growth in the last quarter to 6.3% excluding regulation, driven by a 9% year-on-year growth in mobile service revenue. This sets the scene for a promising 2012.

Increased investments for future growth in the region

As you can see on slide number 27, higher commercial costs dragged OIBDA growth by close to 6 p.p. in the year. The good news is that we achieved superior commercial performance with lower mobile SACs, which are down 10% year-on-year. So, the increase in costs is a direct consequence of higher volumes, not of higher subsidies.

There are other factors affecting OIBDA year-on-year comparisons, like the impact of regulation in Mexico and the lower contribution from regional projects, that more than offset tower sales in 2011.

CapEx to sales reached 18% of our Latin America revenues, up year-on-year on the back of higher investments, showing our commitment with the region and our total confidence in its growth potential.

Brazil: 2011 a year of progress on multiple fronts

Let me know comment on the very strong performance recorded in Brazil.

2011 has been a year of multiple progresses, completing the corporate restructuring and executing the integration process with early benefits coming above expectations, which led us to upgrade the initial synergies targets.

On top of that, in the second half of the year we have enhanced commercial activity, being active in all fronts: new tariff plans were announced, new services were launched and we entered into new areas, leveraging the best spectrum portfolio in the market and very attractive prepaid propositions.

Moreover, we have widened our quality gap versus competitors, increasing the difference versus our peers in 3G coverage and further expanding selectively fiber in Sao Paulo to increase speeds and quality in our fixed broadband business.

Brazil: Strengthened leadership and solid profitability

All these actions have led to very strong results, as shown in slide number 29.

In 2011 we have further expanded our leadership, gaining value share in the mobile market, while we continue to lead the FBB market in Sao Paulo.

The strong commercial momentum translated into revenue, with year-on-year growth accelerating in the fourth quarter, on the back of mobile service revenue acceleration and sound FBB & TV revenues performance.

And our margins are the best in the market, despite the strong drive in commercial activity, leveraging on synergies realization, which are more visible below the operating lines in the P&L.

No doubt, we are in the best position to continue leading the growth in the largest market in Latin America. These excellent results are being recognised by the market with Telefónica do Brazil shares appreciating since the results announcement and accumulating a 30% relative outperformance vs. the index in the last 12 months.

South Region: further advances to transform the businesses

Turning to slide number 30, I just want to stress the strong commercial activity across of our properties in the South region, setting the basis for further revenue growth, combined with sound margins. These operations generated in 2011 close to €2bn in operating cash flow.

There are different market realities across the region but one thing is common, Telefónica is leading the transformation in the business, our MBB penetration is unmatched and we are a step ahead. In these countries our integrated approach becomes a true competitive advantage.

North Region accelerating growth
On the next slide I want to highlight the acceleration in North Region revenue growth.

Regarding Mexico, where 2011 results were heavily impacted by regulatory headwinds, we are focused on quality growth, with a very marked improvement in outgoing revenue trends in the second half of the year.

2012 outlook: Ramp-up in growth leveraging best asset portfolio in Latin America

Looking into 2012, we expect growth to accelerate in the region.

In Brazil, we will leverage on the foundations set in 2011 and integration synergies will be key to free resources and support our aggressive growth strategy.

Commercially, we will benefit from the attributes of having the best brand in the market nationwide and for all our services, as Vivo will be the single brand as of the first half of the year. We aim to consolidate our mobile leadership across all segments, with special focus in MBB. In FBB, we will leverage network upgrades in Sao Paulo, and we have already started to move outside our traditional area of influence with very attractive propositions in a potential market of more than 50 million households representing 65% of the Brazilian GDP.

In the rest of the region, we will prioritise the mass market adoption of FBB & MBB, on the back of bundles, tiered pricing, cheaper devices and enhanced network capabilities. Commercial strategies will be adapted to particular market conditions, with a clear focus on leveraging our integrated position in markets like Argentina, Chile, Peru and Colombia.

T. Europe: Improving commercial momentum, leading MBB adoption in our markets

Let me now review our operations in Europe, starting with 2011 performance.

As César mentioned before, in the summer we decided to revisit our commercial strategies in key markets, launching new propositions that together with the solid uptake of smartphones led to an outstanding improvement in commercial momentum in the fourth quarter of the year, both in mobile and fixed broadband.

Our lead in the MBB market resulted in a strong performance in mobile data, with smartphone penetration up 8 p.p. year on year to 27% of our base, and non-SMS data revenue delivering a solid 30% organic increase, clearly outperforming main competitors across key markets.

Spain: New offerings already paying-off

Moving to the specifics of Spain, on page 34, I'd like to highlight the significant commercial improvement across businesses. The new tariffs launched allow us to better compete in the marketplace.
FBB net adds turned positive in the fourth quarter, with a marked evolution through the quarter. There is a clear preference for the higher value products, with 2/3 of the customers opting for the new tariffs of 24.9€, a price point that is above previous promotions, and allows to sustain the improving trend in connectivity ARPU.

On the mobile side, net adds reached record levels since the end of 2010, with better results across segments and the best ever net adds in MBB, over 400 thousand in the fourth quarter.

Mobile data ARPU showed a very strong evolution along the year, with sustained double digit growth in the last quarter. On the other hand, voice ARPU worsened in the fourth quarter, impacted by a weaker private consumption, cuts in MTRs and price repositioning, which will drag revenues in the short term, but will help to increase gross adds and reduce churn in coming quarters.

Spain: Significant progress in strategic areas in 2011

In 2011 we also took other decisive actions to make structural progresses in Spain that are already bearing fruit.

On the costs side, the increased flexibility on personnel expenses led to a rise in salaries below the CPI, while a fast execution of the new redundancy program will lead to savings of over 200 million euros in 2012. Close to 2,400 employees have already left the company and another 2,000 will join the plan this year.

We also increased CapEx intensity, not only in absolute levels but also in relative terms, with a 12% CapEx to sales ratio, as we continue to expand capacity and coverage in MBB and to selectively roll-out fibre. On top of that, we invested over 800 million euros to ensure the best spectrum in the market.

Finally, Q4 financials reflect the impact of price changes and lower usage in a weaker economy, which impacted mobile service revenue. On the other hand, fixed revenues proved more resilient, posting a sequential improvement.

Top line pressure flew directly to OIBDA in the quarter, as benefits from the workforce reduction were negligible and increased commercial activity limited savings.

Spain: A clear roadmap to turn around commercial momentum and improve financial performance in 2012

Our 2012 priorities for the Spanish business are outlined on slide 36.

We have a clear roadmap to turn around the performance along the year, starting with improved commercial results, on the back of more competitive propositions and new measures to increase customer satisfaction. These actions should allow us to improve gross adds, reduce churn, and stabilise market share performance. As a result, we expect customer growth to help top line evolution although tariff repositioning will impact revenues in the first half.

On the cost side, savings from the redundancy program will flow since the beginning of the year, while the lower churn should positively impact commercial costs. On top of that, we will further benefit from OpEx efficiencies derived from outsourcing, handset portfolio optimisation and the support of TGR.

UK: Stronger finish to the year in commercial terms

Moving to slide number 37, Telefónica UK finished the year with strong traction in the contract segment, recording the best quarterly net adds in the fourth quarter, driven by the new commercial focus introduced in August.

Our priority was to increase loyalty within the highest and most profitable smartphone base in the UK market. To achieve this goal, we encouraged the adoption of new integrated tariffs and offered the newest high-end smartphones first to existing customers coming out of contract, which led to a 35% year-on-year increase in upgrades in Q4.

The renewed commercial momentum amid sustained top line pressure impacted OIBDA margin in the quarter, which stood at 24.2% and 26.5% for the full year.

UK: Robust mobile data offset by adverse market conditions

Despite strong competition, we continue to lead smartphones adoption in the UK, expanding penetration in our base by close to 9 p.p. in 2011. More than 80% of contract customers in the consumer segment were under tiered schemes at the end of December, with most of them opting for one of the two top tier data bundles.

As you can see from the service revenue waterfall, mobile data, including SMS, is adding the most to 2011 performance: 4 p.p., to represent 47% of the total, but this was not enough to offset the drag from regulation and a weak macro environment, which is accelerating lower tariff options and fit-to-bundle consumption from customers.

OTT arbitrage risks continue to be well addressed, with 75% of service revenues in the contract segment included in a bundle; this is 3 p.p. more than in 2010.

Germany: a story of success in a profitable market

Turning to slide 39, we have completed a very successful year in the German market, maintaining a strong commercial momentum and improving monetisation of mobile data, thanks to the continued development of the O2 Blue tariffs and the traction in business and low value segments through exclusive partners.
Contract net adds ramped-up in Q4, while we maintained our leadership in smartphone adoption, at 90% of total shipments.

Mobile service revenue growth, excluding the impact from regulation, recorded a strong growth at over 7% year-on-year in 2011, mainly driven by mobile data, with non-SMS revenues rising close to 50% in the year.

A solid sales performance, coupled with full benefits from efficiency plans led to a 39% organic growth in Operating Cash Flow, while OIBDA margin increased to exceed 24% in 2011. In summary, very strong improvement in Germany.

2012 outlook: Strengthening positions in two key markets

Looking into 2012, we aim to strengthen our position both in the UK and Germany, two key markets for Telefónica.

In the UK, we aim to recover momentum and stabilize market share to drive better revenue dynamics, capturing and retaining high value customers while keeping our leading position in the mobile data market. This will be achieved through significant commercial spend coupled with increased focus on customer experience, including innovation around new digital services.

In Germany, we aim to continue outperforming in a very profitable market. Network quality, customer satisfaction and converged approach in the definition of product & services will be key to achieve our goals in a more stable regulatory environment. LTE will be a main driver for future growth, in 2012 centered around smartphones and urban network deployment, adding the benefits from network collaboration with DT in the backhaul.

Czech R.: Outstanding OpCF, sustained improving trends

Finally, I just wanted to highlight the continued improved performance recorded in the Czech Republic, both commercially and on the financial side which, together with the new shareholder remuneration structure, led the stock price to rise over 7% on the day of the earning release.

Making the most from our new global units

To finalise, let me now spend a few minutes to explain how we will maximise the benefits arising from the launch of the new global units in 2012.

Telefónica Digital will continue to develop its strategy of growing revenues above connectivity from digital assets in high potential marketplaces, exploiting profitable partnerships with main actors in the industry while protecting Telefónica's core communication business in tight coordination with the regions. We are making significant progresses, as evidenced by the recent agreements signed to launch financial services, or the brand new long term contract with Onstar on the M2M space. We will provide an specific update on TD's strategy and goals ahead of Q2 results.

In parallel, the launch of T. Global Resources is already allowing us to accelerate the generation of additional synergies to fully exploit the economies of scale. We are already working on several flagship projects with high value impact. In fact, main projects are already on the way in key areas such as procurement, particularly on the devices side, and Network & IT, which together should lead to benefits over 1 billion euros in 2012. On top of that, we will further advance in network collaboration schemes with third parties and on the sale of non-core infrastructure to get additional efficiency gains.

Let me now hand it back to César, for the closing remarks.

Closing remarks

Thank you Angel.

It has been a long presentation, but let me sum it up.

We have the right fundamentals for sustained profitable growth.

We have recorded a promising commercial momentum heading to 2012.

We will prioritize investments to drive forward growth.

We are determined to improve financial flexibility.

And we are fully committed to offer very attractive returns to our shareholders, and we can do it.

Thank you very much for you attention. Now we are ready to take your questions.

Q&A session

Tim Boddy - *Goldman Sachs*

Thanks. I wanted to ask about your guidance for 2012, do you expect to sell more towers in 2012? And is that likely to help your EBITDA performance during the year?

And secondly, on SMS substitution risk, if I've got the numbers right, there was an acceleration in the decline in SMS, both in the UK and in Spain in the quarter. Can you talk a bit about trends in SMS and IP substitution risk in your European business?

Thanks very much.

Julio Linares - *Telefonica SA - COO*

This is Julio Linares. Thank you for your question. Well, when we set up the guidance for this year, as always, we tried to maximize our operational assets, and in order to do so, we always analyze what assets are strategic or they are not a strategic, what assets we should control or we do not need the control, in such a way that we are able to externalize those assets that we believe that are not strategic for us. And then we focus on the resources in the best possible way. This has been the way that we set up our OIBDA guidance every year and we are keeping this practice in the year 2012 as well.

José María Álvarez-Pallete - *Telefónica S.A. - Chairman & CEO Telefónica Europe*

Taking your question of SMS evolution in Europe, there are different realities across different units, for sure depending on the tariff structure, but let me highlight that for example in the case of Germany, the number of SMS has been significantly increased all along the year, even though, precisely probably, because we have a bundle strategy of bundling voice and SMS in the German markets. So, in the German market it is not being an issue so far.

In the UK, it is true that the number of messages or SMS for customers is showing a slight decline, but it is also true that we have bundle and flat SMS tariff and therefore in terms of revenue, we're not exposed to that evolution, because we thought that was going to be the case and we prepared our tariffs for that.

And in the case of Spain, you know that we recently changed our tariff structure in Spain, because in Spain we're exposed to the SMS evolution and therefore, we bundled at the end of last year voice and SMS and data having a flat rate, where SMS are included in some of our tariffs.

So Spain was the case where we were more affected, but we have been trying to immunize ourselves to this evolution through these bundles and through this flat tariff.

So for the time being, we think that we're protected with the current tariff scheme that we have.

María García-Legaz - *Telefónica S.A. - Head of IR*

Next question, please.

Georgios Ierodiaconou - *Citigroup*

Hello, I've two questions, please. First one is a follow-up on the previous question.

Whether you can give us some idea of the magnitude of tower sales that you expect in 2012? And if I would put it differently, if we look at the portfolio of our guidance for a 2% decline in EBITDA margin, could that be the case even if you have a fairly significant program for tower sales this year?

And my second question is on the data you gave us on page 38 about around three quarters for service revenues coming from integrated tariffs in the UK, is it possible to give us a similar number for Spain, a comparable number for Spain? And perhaps, if you could give us an idea of how this has been evolving during 2011? Thank you.

Julio Linares - *Telefonica SA - COO*

Due to the market conditions, we prefer to communicate the impact of this kind of sales once they are executed as we have been doing on a quarterly basis along 2011.

José María Álvarez-Pallete - *Telefónica S.A. - Chairman & CEO Telefónica Europe*

Taking your second question. We don't have here the exact information replicating the page 38 for the UK, for Spain, but I can give you some flavor of what has been the main reasons behind evolution in Spain: churn, that has eroded part of our value customer segment; then the ARPU, the worse mix between lower and high end customers for Spain all long the year; the decline in SMS revenue till we launch this tariff and finally, we have been taking away some promotions and some actions that were not meeting our customer satisfaction criteria and, therefore, that has affected revenues in the short-term. But I would ask you to get back to our IR department to get more clarity on the specific evolution because we don't have a specific data here.

María García-Legaz - *Telefónica S.A. - Head of IR*

Next question, please.

Ivón Leal – *BBVA Bolsa*

Yes, hello. Good afternoon. Thanks for taking the question. Just on Spain, it would be very useful, if you could share a bit with us, if you perceive any change on consumer trends in Spain in the first two months of the year, given that we have austerity measures now hitting the street. And eventually, and depending on how the year is going, if there is potential for further other OpEx cuts in Spain also for 2012.

José María Álvarez-Pallete - *Chairman & CEO Telefónica Europe*

In terms of consumer trends, they remain weak in Spain in the first two months. So, a similar trend to the last quarter of the previous years in terms of overall market sentiment from the consumer standpoint. So, for the time being, no good signs on that side.

And in terms of OpEx reductions, we keep looking for efficiencies. Remember that this year we will fully benefit from the employee reduction program that we launched last year. So, it will flow within this year through our P&L.

And on top of that, you should expect from us that we will be more, I would say we'll be adapting our subsidy strategy during this year in Spain in order to be much more focused on our existing customer base, and therefore having the bulk of our efforts in the commercial side retaining our high-end value customers and therefore trying to avoid significantly churn.

So, those are the flavors that I can share with you right now.

María García-Legaz - *Telefónica S.A. - Head of IR*

Next question, please.

Will Millner - *Arete Research*

Thank you. I just wonder, on the leverage, what's driven you to commit to the reduction in leverage by the end of this year now. I think it implies around 5 billion euros of debt reduction based on the guidance and the dividend policy.

Ángel Vilá - *Telefónica S.A. - Chief Financial and Corporate Development Officer*

This is Angel Vila. With respect to leverage, we have closed 2011 above the level that we guided to the market. This has been the result of a deterioration in the macro and financial environments across Europe. So, our debt figures have been impacted by adverse foreign exchange movements, the euro depreciation versus other reporting currencies. Obviously, it has also affected our operations, as it has been expressed before by some of my colleagues.

One other matter affecting the increase in the leverage when you give commitments is that we have had a higher take-up in our employee redundancy program in Spain to 36% instead of 33%. And this clearly will impact in better savings for next year.

Also, having seen the excellent progress of our free cash flow generation, we decided to dedicate further resources to the share buyback in order to anticipate cash savings for

2012 shareholder remuneration. So, this has led us to finalize our leverage above what we had guided for year-end.

Looking into 2012, we expect leverage to be reduced based on several factors. First, as I expressed in the presentation, we have some actions that have taken place post the closing of the exercise where we are already reducing net debt. We have the Colombian debt restructuring. We have been selling stakes, minority stakes in Hispasat, in Portugal Telecom, in ZON in some other assets.

Also, we are going to continue progressing on measures like working capital management that this year has had a very positive contribution to our free cash flow. And we expect to also be the case in 2012, albeit could be a smaller positive effect.

If you take into account all of these effects, and also as you have seen on slide 15, the cash-out which is related to shareholder remuneration is going to be significantly reduced as compared to the one that we had in the previous year. So, all in all, we expect to have organic deleverage by year-end in addition to what may come from a further streamlining of our portfolio of assets.

Justin Funnell - *Credit Suisse*

Thank you. Yes, a couple of things. I just wondering first if you'd be a bit more explicit about your commercial costs in Spain, Vodafone, when they cut price initially in May 2011, made it pretty clear that they were hoping that a lower ARPU price point would ultimately lead to lower SAC. We haven't seen that yet in the market. But, do you think that strategy of yours on lowering commercial costs is really part of that process and that we should see the Spanish mobile market become ultimately more profitable across the markets later this year?

Secondly, I notice your relatively positive comments about mobile data in the UK and the question of tiering with a lot of your customers on higher tiers. We're seeing again Vodafone questioning whether tiering is working and are customers really spinning up to higher plans. I was wondering if you could share any of your experience. Perhaps you're having a more positive experience.

José María Álvarez-Pallete - *Chairman & CEO Telefónica Europe*

Trying to be more precise on the comments that I made about commercial costs for this year in Spain, what we have done all along year 2011, starting in July and keeping going in November, in terms of repositioning all of our targets, we are trying to do two things.

First of all, aligning our commercial effort, because we were out of the market and we were losing relevance in terms of the market and we wanted to get back some commercial momentum, which we did, again starting by the tariff that was launched in July and keeping it in September and back again in November.

And we are betting that, thanks to that, we will be able to reduce churn because, at the end of the day, we are there in Spain, we have the largest customer base and we have probably the most valuable customers. And we wanted to reduce churn as a way to try to preserve the high end customers and therefore to stop the erosion in terms of service revenues.

That's, it's too soon to say because it's just two months after the last launch of the tariffs, but it is going into that direction. So, the first signs are positive, so we'll keep going into this path.

And on top of that, you are right. We think that the next step should be more rational behavior in terms of the subsidies policies in Spain, because we, at the end of the day, we want to invest this amount of money or to use a significant part of this amount of money to preserve and to give the best value to the existing customers, and therefore, once again trying to reduce churn.

So, if I had to summarize what are the main guidelines below our strategy of the commercial repositioning, it's to try to be much more competitive to gain commercial momentum, which we have done, and to be able to reduce churn, because us having the largest customer base, we are the most ideal candidate to churn on.

We have been doing several actions in terms of bundling data with SMS, in terms of bundling data, SMS, and voice, cross bundling with broadband, with fixed with wireline broadband, and this is taking traction.

So, we think we are on the right track. We think that this is the right direction. We think it is the role of the leader of the market to show the way of the rationale behind the market, and that's what we are trying to do. And as you might imagine, we are monitoring very closely.

And in terms of your question about the UK market and the comments, we are not going to comment on the comments of Vodafone, as you might imagine. But, we did a status refresh in August last year which helped us to gain more commercial traction in the UK. In the month of November with the launching of the iPhone 4S, we bet on the existing customer base precisely to try to avoid the churn, because keep in mind that we have the most valuable smartphone customer base in the UK market. And as you might imagine, we are closely monitoring every single movement on the UK market.

But, for the time being, with the traction that we got from the August refresh of tariffs and with the current strategy, we think that we are on the right direction. We are gaining some commercial traction. Were the conditions in the UK market to change structurally, then we will reconsider.

María García-Legaz - *Telefónica S.A. - Head of IR*

Next question, please

Luis Prota - *Morgan Stanley*

Yes, thank you. I have two questions on Spain and both on tariffs. The first one is on the new mobile packages that were launched in the fourth quarter and whether these packages are behind the accelerated decline in ARPU in the fourth quarter, whether you've seen any material trade down effect that could potentially turn into ARPU accretion in 2012 as up selling succeeds. That's the first question.

The second question is again on tariffs but now is on DSL and whether you could give us some kind of indication on what percentage of existing DSL customers were also mobile contract customers and therefore could apply for the 25 euros tariff, and also what percentage of them have actually migrated to this tariff already. Thank you.

José María Álvarez-Pallete - *Chairman & CEO Telefónica Europe*

Thanks, Luis. Taking your question on the effect of the bundles, I mean, again too soon to say that with the information, because it was just launched in November. But, as you might imagine, we are monitoring that on a daily or weekly basis.

With the information that we have right now, the effect that we were looking for with this repositioning has been in the right direction, which means that we do not see, on the customers being on the new portfolio, having a worse performance than the customers on the preexisting portfolio, which means that all the things being equal, I mean, all of our customers being affected by the overall market sentiment, the customer that has chosen to go into the new portfolio first are showing a better performance than the others.

And on top of that, churn of those customers are going into the right direction. Churn of those customers are lower than the one before, even though churn is a very early stage because it's just two months. So, it's too soon to conclude that this is going to be the behavior along the year. But, so far it's going into the right direction.

So, we think that the market repositioning is working well because it has allowed us to be much more competitive and to get commercial traction. It shows lower ARPU decline than the customers coming from the preexisting portfolio of products and helps us to be much more relevant from a commercial standpoint.

And taking your question on the DSL, I don't have here the figure of how many customers of DSL are subject to bundle with. But, what I can say is of this new tariff of the EUR19.9 and the EUR24.9, the current mix is two thirds EUR24.9 of new adds, one third of EUR19.9 new adds. So, again going into the right direction. The value-added services look to be attractive in terms of the terabox and the additional bundles. So, again, too soon to say, but things look like going into the right direction.

María García-Legaz - *Telefónica S.A. - Head of IR*

Next question, please

Robin Bienenstock - *Sanford Bernstein & Co.*

Yes, good afternoon. Thanks very much. Two questions, if I may. The first is that we seem to be seeing huge value being sucked out of the industry by handset manufacturers, and in particular Apple. And that looks like what I'm seeing in the UK Q4 numbers. So, I'm wondering if there's anything that you or your competition can do, like investing significantly more in a differentiated network or something else to stop that process.

And the second question is about your net debt to EBITDA targets, which is so, am I right in assuming that you're going to include asset sales of towers in the EBITDA number when you think about those net debt to EBITDA targets? And isn't that a little odd, given that the tower sales will presumably have a negative impact on your EBITDA going forward?

Julio Linares - *Telefónica S.A. - COO*

I think the best we can do in the industry is to provide a good quality of service to our customers, to provide better bandwidth to our customers, and really to keep going on our offer in order to include more applications on the entire services, together with connectivity.

And as I said before, we would prefer not to provide early information about the sales that we could do through the year, taking into account the market conditions. And we will provide that information on a quarterly basis as we executed the projects.

María García-Legaz - *Telefónica S.A. - Head of IR*

Next question, please?

Jonathan Dann - *Barclays Capital*

Hi there. Two questions. The first one, the tower sales contributed, I believe, 100 basis points positively to the 200 basis points decline in margin. Was that more or less than you thought, say six months ago, when you guys were thinking the second half could get better?

And my second question, you highlighted EUR1.5 billion of debt reduction from Colombia. Could you remind us what the sort of equity side of that is and if there's any book value changes you need to make?

César Alierta - *Telefónica, S.A.- Chairman & CEO*

To tell you about the tower sales, if you look at our number in 2011, the regional projects in 2011 was much lower than we presented in 2010 and much lower than the sales of tower sales. I said during the presentation we have 100,000 towers, okay? And you can believe that many of those 100,000 towers are not strategic at all. They are not part of our core business. They are not strategic at all, okay?

Why we have less regional projects in 2011? Because the potential we have now in the value chain because of the new digital position that we have. And we are putting the effort in the end value of the digital chain, where we are going to grow a lot is where we are going to make the effort more than in 2010.

So, the number of towers is irrelevant for the growth potential. So, don't so much worry about the tower sales, because it's irrelevant, okay?

Ángel Vilá - *Telefónica S.A. - Chief Financial and Corporate Development Officer*

With respect to the Colombia debt reduction, the EUR1.5 billion figure is not only Colombia. The Colombian figure would be about EUR1.3 billion. And this is the result of an agreement reached with the Colombian government. That has been approved by the Parliament of such country and has been published in a Presidential decree.

Basically what is public already is that the Colombian nation will be taking on their books 48% of the liabilities that corresponded to our fixed line business as part of capitalization of that company. And our share of capitalization of the company will be taken by merging the company with our mobile operation in such country, deriving synergies from that fixed and mobile integration.

This process is very, very advanced. We have reached agreement and it's pending some formal execution steps that will take place in the next couple of weeks.

María García-Legaz - *Telefónica S.A. - Head of IR*

Next question, please?

Fabián Lares - *JB Capital Markets*

Hi. Good afternoon. Thank you for taking my question. Related to the repositioning and commercial offer, in particular what you've done both in the UK and in Spain to move away from the value positioning and more towards the commercial positioning to maintain customers and basically go back into the market as you are now positioned, can we take it as a given, then, that this is going to be the trend moving forward and thus the positioning for value for money is no longer relevant as was stated in the Investor Day in April? That'll be my first question.

And second, related to the net debt to EBITDA target of 2.61, or 2.63 now, does that in any way, shape for, or compromise your possibility of having, considering you have a negative outlook and ratings with the two agencies, which this could mean that you could be downgraded?

Thank you.

José María Álvarez-Pallete - *Telefónica S.A. - Chairman & CEO Telefónica Europe*

Well, taking your question on the new tariff launching both in the UK and Spain and if it is volume or value, the worst case scenario is that being under positioned, and I would say not well positioned, commercially speaking, we had the threat; we were suffering the fact of high end valuable customers leaving us. And therefore, we wanted to be back on the market precisely to be able to both retain the valuable customers and be back relevant on the commercial side. And that's what we have done both in the UK and in Spain. In Germany, our commercial launching of our commercial tariffs is in very good shape. So, I would say that it is not giving away volume or value. It's that we were, I would say, not relevant commercially speaking and we were losing a significant amount of very valuable customers to our competitors. And that's precisely what we want to avoid.

And that also explains the fact again that you will see all along this year, mainly here in Spain, that we will be much more rational on the subsidies because the preference is going to go to preserve the most valuable customers that you have. And therefore, most of our commercial efforts are going to be devoted toward valuable customers in every single market. Namely here in Spain, as well in the UK in terms of the smartphone base, we have the most valuable customer base. And that's precisely what we want to preserve.

Ángel Vilá - *Telefónica S.A. - Chief Financial and Corporate Development Officer*

And with respect to the leverage ratio, our target is 2.35 net debt, net financial debt to OIBDA. We stand today at 2.46. And after the post-closing debt reduction actions, we would be around 2.4 times.

This objective of 2.35 net financial debt to OIBDA is equivalent to the previous net debt plus commitments divided by adjusted OIBDA of 2.5 times, which we will continue to report. So, you should not be concerned about this change, because it's equivalent, what we are stating, in one or the other ratio.

By the way, this ratio is not only known by the rating agencies, actually in some of the recent reports, for instance Moody's, they were using these ratios when they published. So, the financial position is known. It's public. And regardless of whether you're using one ratio or the other, what we are committed is to work in the direction of reducing leverage, which, again as I said in the first two months of the year, we have made substantial progress in that direction already.

María García-Legaz - *Telefónica S.A. - Head of IR*

Next question, please?

Torsten Achtmann - *JPMorgan*

Hello. Two questions, please. First on Spain, is there any chance you can quantify the impact you have seen in revenues in the fourth quarter from rebalancing the SMS tariffs into the voice package, how much negatively influenced revenues?

And secondly, on Latin America, it seems in a few markets, competition is increasing, Chile, Brazil, some of the other markets. Is that a trend you expect to continue in 2012? And given that you started increasing commercial activity to gain customers last quarter, do you continue to spend on customer acquisitions and therefore driving gross customer acquisitions? Thank you.

José María Álvarez-Pallete - *Telefónica S.A. - Chairman & CEO Telefónica Europe*

Taking your question about SMS evolution and the impact that the new tariffs may have on the revenues coming from the reduction of SMS in Spain, it is very hard for us to say because we have bundled that. And therefore, for us now it's much more in terms of allocation. We are approaching that through our data. We are seeing data expansion in terms of consumption. So, it is very tough for us to see that here.

But, we have come in Spain to the same strategy as in the UK and Germany, bundling in order to be much more inelastic or less exposed or more hedged toward the reduction in SMS. So, we don't have information here to tell you that, because it is now bundled and therefore we are not seeing that impacting revenues because they are bundled in the tariff.

Let me share with the only information that can help you to conclude. Let me remind you that our SMS is just 6.5% of total mobile service revenue in Spain before the bundling. So, the exposure is very limited and is now bundled.

Santiago Fernández Valbuena - *Telefónica S.A. - Chairman & CEO Telefónica Latinoamérica*

Hi, Torsten. This is Santiago. On your question on Latin America, it is certainly the case that competition is picking up, but it's picking up for the right reasons.

In one case or in some cases like, say, Chile, it's because the market is approaching maturity. New entrants are trying to carve a niche in the market, and therefore the temperature rises. There where temperature is rising, we have, however, the strongest starting point. And it's difficult to assail an already established position.

In other markets like, say, Brazil, what's happening is that growth is accelerating. So, yes, commercial expenditures are up, but they are up for the right reason. The right reason is that net adds are rising, the quality of these customers is rising, and, again, the newcomers are trying to establish a point and not quite succeeding all the time.

So, the short answer would be yes, we still think that the commercial activity is going to be performing very well. Net adds are going to increase. And the already established operators like ourselves are likely to derive some benefits, although not in the short but more in the medium term, let's say four to six quarters ahead.

Torsten Achtmann - *JPMorgan*

Thank you.

María García-Legaz - *Telefónica S.A. - Head of IR*

Next question, please?

Keval Khiroya - *Deutsche Bank*

Yes. Hi, everyone. So, two questions on LatAm. Firstly, can you provide some color on how much support we should get from the Vivo synergies in 2012 vs 2011? And can you also give us some color on what the integration costs will be like in 2012 as well?

And secondly, following up on the question on commercial activity in LatAm, from that should we interpret the EBITDA delivery in LatAm will continue to be weak in 2012?

Santiago Fernández Valbuena - *Telefónica S.A. - Chairman & CEO Telefónica Latinoamérica*

Santiago again. On the Vivo synergies, we have little to add to what we have already said. We think we are approaching nicely and gently the upper end of the synergy band that we set for ourselves on both the non-operating and operating synergies. Remember that the top line number was about EUR4.4 bn.

The strictly operational synergies are proceeding nicely. And I think we should be able to provide some detailed numbers about them sometime in the first half of this year, because the restructuring is not fully complete and we are wary that some numbers might compromise our position in some of those areas.

And in terms of commercial activity, I think I have to reiterate what I just said regarding other markets. I don't feel particularly challenged in any special markets, so Brazil is certainly not an exception. And I think that what you are likely to see is an acceleration of the efforts of the substandard players in the market to gain share and probably not much success stories coming from them.

Maria Garcia-Legaz - *Telefónica S.A. - Head of IR*

Next question, please?

Stanley Martinez - *Legal & General Investment Management*

Hello everyone. Good afternoon. Thank you for taking my questions. First, just briefly on Venezuela, can you refresh on your foreign exchange assumption, specifically whether you see any reason for changing from the official EUR5.56 exchange rate to something close to the implied grey markets, which I think is closer to VEB8 to VEB9 per euro.

And then, secondly on Mexico, if I strip out the EUR217 million gain on the tower sales, it looks as though Movistar had a 17.5% service revenue margin despite losing sub-share. And since Mexico is the only country where you go to market with more of a pure mobile focus, my question is what changes specifically in the commercial mix between distribution, tariffs, brands, subsidy, network to rebuild back toward your performance levels of a few years ago, or do you really need a change in asset mix in addition to potential changes in regulation?

Ángel Vilá - Telefonica S.A. - *Telefónica S.A. - Chief Financial and Corporate Development Officer*

Hello, Stanley. First on Venezuela, we are accounting at the official exchange rate in the country. This situation may evolve, but at this stage we don't have a better estimate or an assumption that we may share on this topic. I would maybe just add that we have also been able, during 2011, to repatriate over USD$200 million from such operation which continues to perform quite nicely.

Santiago Fernández Valbuena - *Telefonica Latin America - Chairman, CEO*

Hi, Stanley. Santiago again. Three quick comments, Mexico is a complex place because competition is established in another manner relative to all other markets in the region. We are working on two main fronts. One is to make it surface, make a healthier customer base surface. So, we're trying to be more demanding on what we require of our commercial distributors. So, distribution is certainly one channel we are working on and making progress in. This is likely to provide a healthier customer base where churn is easier to manage.

Are we satisfied with the margins? We are certainly not, and we are working towards extending those margins on the right way, which is not by increasing activity but by increasing the stickiness of our own customers.

The numbers of Q4, there are a number of things. Not all of them are easy to disentangle, but you might also look at some negative effects which are substantial relative to the size of the OIBDA generated in the quarter to the tune of EUR23 million. So, I don't want to play with the numbers, saying this is recurrent and not recurrent too much. But, certainly that may add to the apparently lowest number that we have published.

María García-Legaz - *Telefónica S.A. - Head of IR*

Next question, please.

Jerry Dellis - *Jefferies*

Yes. Thanks for taking my question. Two questions please. Firstly, in the UK on slide 38, you show quite a large optimization impact depressing UK mobile revenues. Given how many customers are on integrated tariffs now, I wondered whether you could sort of explain in practical terms how customers are optimizing their usage in order to sort of spend less at this point.

And then, a second question on Brazilian fixed line. It does look as though, if we adjust the reported numbers for the TVA acquisition in Q2, revenue trends have deteriorated somewhat in the last couple of quarters, underpinned by what looks like worsening lines and rather weak pay TV adds. Just wondered whether you could help us sort of understand the outlook for the Brazilian fixed line business in 2012, please. Thank you.

José María Álvarez-Pallete - *Chairman & CEO Telefónica Europe*

Taking your first question on the UK market and trying to split up the mobile revenue deceleration reduction of basically 3.7 percentage points in the quarter, I would say 20% of this reduction, mainly the 0.8 percentage points, are coming from lower customer base growth both in prepaid and in postpaid. That's precisely we are trying to address being much more relevant in the market. So, part of the deceleration is because we have less customers because we have been less active in the market.

And 80% of the remainder is due to lower incoming and out of bundle traffic. We are suffering from the consequences of a soft economy, of course, and lower consumer sentiment. And on that side, the consumers are being much more, I would say they're optimizing much more of their bundles. So, it's roughly 20% coming from a lower base, both in prepaid and postpaid, and 80% coming out of bundles.

And that is why, in the quarter where we have seen a high number of upgrades and contract resigns, we need to be certain, assured that we are focusing our retention efforts precisely to address that. So, that's the explanation, the split up of this 3.7 reduction.

Santiago Fernández Valbuena - *Chairman & CEO Telefónica Latinoamérica*

Jerry, Santiago again. On Brazilian fixed line, I think I would summarize the situation as follows. You have a declining revenue trend from voice fixed services. This is unlikely to be stopped and it is falling a bit faster than broadband adoption, and increases in penetration are rising. So the net effect is either a small negative or a small positive, depending on the quarter. And because we are by far the largest player, we are likely to continue suffering some erosion from traditional fixed lines.

What I think the good news are, is number one, that the total size of the pie is increasing. If you take a couple of quarters' view, you will see that because the market is expanding and underlying incomes are rising, the overall value of the market is actually rising. And eventually we think this is the trend that is going to prevail.

On TV adds and our acquisition of TVA last year, those are events that happened in specific times. But we would not ascribe a lot of interest to them, because they depend a lot on tactical reasons of deployment here and there.

You know, because we published that when we published the Telefonica Brazil numbers, that we're trying to expand seriously on the fixed, I'm sorry, on the fiber to the home activity, that we had a lot of homes passed and we are now shifting the trend and the attention towards homes connected. This is not an easy thing, but we think we're uniquely positioned along with our cable deployment, to get the best value out of those large investments that are already have made but not quite developed yet.

María García-Legaz - *Telefónica S.A. - Head of IR*

Next question, please.

Luigi Minerva - *HSBC*

Good afternoon. The first question is on Telecom Italia. Their dividend cut today may hurt the ability of Telco to be able to service their debt and also to maybe refinance the EUR3.4 billion which are due this year. Can you give us your view on that and whether that may lead to reconsider your position within Telco?

Secondly, on Brazil, the Brazilian press is speculating about the introduction of ULL by the end of this year. Can you give us an update on your views about the process with Anatel? Thank you.

Ángel Vilá - *Chief Financial and Corporate Development Officer*

Hello Luigi, this is Angel. On Telecom Italia and Telco, we are happy shareholders in Telco. In fact, as you say, we need to do the refinancing this year of maturing debt. So the first step that will be very likely adopted by the partners, is to renew the shareholder agreement and then, we still start our conversations with creditors. Of the total debt of Telco, EUR2.1 billion is bank debt and that's the one that will need to be refinanced by midyear.

The reduction in the dividend of Telecom Italia clearly reduces the income for Telco, but still provides the ability to refinance that debt at what we think are going to be the new market conditions for it. We will start negotiations with financing entities very early on this refinancing, and obviously it will be quite public what will be the result of it. Telco continues to be free cash flow positive, even after this dividend cut.

Santiago Fernández Valbuena - *Chairman & CEO Telefónica Latinoamérica*

Yes, Luigi. And in terms of the possibility of the Brazilians introducing ULL, well it's anybody's guess, the Brazilian authorities and the government entity, regulatory entity agency Anatel, are moving very fast in very different directions. I'm sure that not all of them can be brought to a conclusion this year.

And ULL is probably too late. If you ask my own personal opinion, it's probably too late in arrival because the Brazilian, the Sao Paulo market is already well developed and well served. It is unlikely that opening up the ULL, which is a European invention of dubious consequences and benefits, will be successful there because most of the broadband is already developed on either cable or fiber grounds, and set VDSL is also present.

So, to be plain and straight, I don't know what the outcome will be. We do not think as a Company that ULL is such a great regulatory piece. But if it comes, then we'll have to adopt. Let's also not forget that we are talking of the Sao Paulo market, but that we have just entered selectively the non-Sao Paulo market, which is 60% of Brazilian GDP. And we can access that not by ULL but also by fixed wireless telephony, and this is a great promising fast growth area.

So, whether or not it comes, I think it's going to have very minimal consequences because, number one, most of the birds have been taken by either cable or fiber or the existing VDSL, or we will be successful or we will possibly deploy outside of Sao Paulo, which is exactly what we have been doing since Q4 of last year.

Luigi Minerva - *HSBC*

Thank you very much.

Giovanni Montalti - *Cheuvreux*

Hi. Good afternoon. Thank you. Just a quick question. Should we still consider China Unicom stake as, let's say, a core asset, so not to be included among something you might dispose of? Thank you.

César Alierta - *Telefónica, S.A.- Chairman & CEO*

We are extremely happy with the participation in China Unicom. The potential of China Unicom is tremendous. The potential of the collaboration between Telefónica and China Unicom is tremendous. One thing you should have in mind is that we work together very closely on many fronts, all the fronts on the value chain.

And together, we have nearly 700 million customers, which is a big thing. The collaboration between China Unicom and Telefónica is increasing every time, and we see a lot of potential and synergies that may exist together with China Unicom.

So, I think both of us, Telefónica is very happy with the participation we have in China Unicom, and China Unicom is very happy with the participation they have in Telefónica. And the only thing we see ahead is a much stronger relationship between the two companies.

Maria Garcia-Legaz - *Telefónica S.A. - Head of IR*

We have now time for the last question.

James Ratzer – *New Street Research*

Yes. Good afternoon. Thank you. Two questions, please. The first one was just regarding your dividend policy from Telefonica Brazil. And it strikes me that that company is fairly under levered at the moment. The dividend you approved for year-end was only about 70% of underlying free cash flow. I was wondering is there a reason why you're not gearing that company up further to repatriate more cash? I mean, are you potentially thinking about doing more M&A from that company? Is that the reason why you're keeping the balance sheet under levered?

And the second question I had was regarding O2 UK. I mean, there's obviously been quite a lot of optimizing going on within the customer base at the moment. The commercial cost you're undertaking, though, is that one-off really for this quarter, or do you see that now as a kind of increased level of commercial costs over maybe the next 12 months to reaccelerate revenue growth within that business? Thank you.

Ángel Vilá - Telefonica S.A. - *Telefónica S.A. - Chief Financial and Corporate Development Officer*

Thank you, James. This is Angel. With respect to the question that you had on Brazil, to over leverage that company to distribute dividend could potentially not be the most efficient financial measure for the Group, given the financial cost that you have for that in Brazil. And in any case, we, through the Group cash management mechanisms, have all the benefit of that cash which is sitting in Brazil.

Obviously, we evaluate continuously which are the ways to have the most efficient capital structure, taking into account not only Telefónica corporate balance sheet but also Telefónica Brazil balance sheet.

José María Álvarez-Pallete - *Telefónica S.A. - Chairman & CEO Telefónica Europe*

And taking your question on the UK commercial cost, I don't think you should consider it's going to be just for the last quarter. It's going to keep going through this year, as in the last quarter we had a retention cost and this quarter we are having as well a commercial effort.

So, we want to get traction on the market. And we want to be relevant on the market. And therefore, you should expect from us to keep investing on the commercial side.

César Alierta - *Telefónica, S.A.- Chairman & CEO*

Well, this is César Alierta. I want to thank you very much all for your attendance and your questions in this conference call. In the name of all my colleagues and Executive Committee of Telefonica, I wish you all a very good weekend.