

Telefónica

**Telefónica January-March 2019
Results Conference Call Transcript**

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Introduction

Pablo Eguirón – Global Director of Investor Relations

Good morning, and welcome to Telefónica's conference call to discuss January-March 2019 results. I am Pablo Eguirón, Global Director of Investor Relations.

Before proceeding, let me mention that financial information contained in this document related to the first quarter 2019 has been prepared under international financial reporting standards, as adopted by the European Union. From the first of January 2019 we implemented IFRS 16. In organic terms, the effects of the accounting change to IFRS 16 are excluded in 2019. 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 Chief Operating Officer, Mr. Ángel Vilá.

Presentation

Ángel Vilá – Chief Operating Officer

Q1 Group achievements

Thank you Pablo. Dear Investor and Analyst community, good morning and welcome to Telefónica's first quarter results conference call. With me today is Laura Abasolo, Chief Financial and Control Officer. Following our presentation we will host a Q&A session and invite you to ask any questions you may have.

I would like to start this call by sharing with you our main achievements during Q1.

First, we continue increasing customer relevance by offering the best digital experience. High value accesses continue to be the pillar, and increasing accesses and penetration translates into tangible results. Average Revenue per Access accelerates its organic growth to 4.2% year-on-year, amidst stable churn. Customer satisfaction increased as Movistar ranked 2nd top most valuable Spanish Brand, the only telco brand in the top-20.

Second, connectivity is the foundation to allow the best customer experience; smart connectivity on new high-speed, flexible, secure and advanced networks featuring elements of artificial intelligence.

Third, our growth is consistent and profitable; with revenue improving its growth rate this quarter to 3.8% organic. And revenues continue their transformation process, with 56% of revenues already coming from BB connectivity and digital services. Our OIBDA recorded positive growth, and our earnings are outstanding, with Net Income and EPS growing strongly and FCF improving substantially.

Finally, the clear deleverage path we initiated some years ago continues to be confirmed, with 8 straight quarters of decline in net debt, which stood below the 39 billion euros mark at the end of the quarter when including the sale of both our Central American assets and Data Centers recently announced.

Financial summary

Turning to slide number 2, let me summarise our main financials.

Reported figures for the first quarter reflect the new IFRS 16 accounting standards, with a positive impact of 414 million euros in OIBDA and a negative impact of 17 million euros in net income. Let me remind you that 2018 figures are

reported under IAS-17. As such, year-on-year reported changes reflect on one hand the organic growth and are also affected by accounting changes, by the negative evolution of FX, regulation and other special factors like capital gains among others.

Reported revenues reached almost 12 billion euros, OIBDA stood at 4.3 billion euros, a 35.6% margin, whilst net income exceeded 900 million euros. FCF of 1.4 billion euros is a remarkably strong number, 2.6x larger than in the same period last year, and allowing to reduce our net debt by 5.7% on a yearly basis to 40 billion euros.

On an organic basis, it is worth to highlight the acceleration in the revenue growth rate to 3.8% thanks to improving service revenue trends, while OIBDA posted positive growth of 1.0%.

2019 guidance reiterated

Next slide shows our 2019 guidance, which is well on track following Q1 results and fully aligned with our expectations.

We also confirm the dividends to be paid in the calendar year, and to be approved in the next AGM: 0.2 euros per share on 20th June, which is the second tranche from the 2018 dividend, and 0.2 euros per share on 19th December, which will be the first tranche for the 2019 dividend. The second tranche of the 2019 dividend, another 0.2 euros per share, will be paid in June 2020.

Double digit increase in net income

Let's move to slide 4, where we detail the Net Income components and their evolution.

We have achieved 10.6% annual growth in net income and surpassed the 900 million euros mark, despite FX headwinds and IFRS 16 negative impact.

Reported Earnings per Share reached 0.16 euros, increasing a significant 33.8% versus the first quarter of 2018, reflecting our solid operational performance and further boosted by savings from financial management.

Revenue trends ramped-up

As you can see in slide 5 and as mentioned at the beginning of the presentation, I would like to remark the better trend registered at the top line, +80 basis points sequential improvement vs Q4 2018, to +3.8% in organic terms and +4.6% excluding regulation. The mix of this improvement is important as well, since service revenues ramped-up by 130 basis points to +2.6% positive growth year-on-year and handset sales continued to post a robust increase of 15.6%.

By segments, there is growth across the board and we are benefiting from our unmatched diversification, Latin America being the main contributor to this better performance of revenues, increasing at a pace of +6.2% on a yearly basis and accelerating vs Q4 18 by as much as 260 basis points, while Europe remains growing healthily at 1.6%.

OIBDA growth: both reported & organic

Now let me present the OIBDA performance in the first quarter, which we show on slide 6.

OIBDA grew by 10.3% in reported terms reflecting mainly the positive impact of IFRS 16, while in organic terms it increased by 1.0%, or 1.7% ex-regulation. Main contributors to this organic performance are Hispam South, Brasil and UK, with Spain improving its trend vs the one registered the previous quarter, Mexico facing tougher year-on-year comps.

OIBDA margin topped 35.6%; growing 4 percentage points on a reported basis.

As such, Operating Cash Flow increased 14.6% from the same period last year in reported terms, while in organic terms declined 5.3% affected by CapEx phasing in this quarter, which is growing by 11.2% year-on-year.

Accelerated deleverage on FCF generation

On slide number 7, you can see we are accelerating the deleverage path, bringing down net debt by almost 700 million euros in Q1, again driven by solid FCF generation. This is the 8th quarter in a row of debt decline.

FCF reached 1.4 billion euros, 2.6 times or 858 million euros higher than the one posted in the same quarter last year. This remarkable performance is mainly explained by our operations performance and the tax refund obtained in Spain, despite negative usual seasonality impacts during this period of the year. For the rest of 2019, we expect WC seasonality to swing and positively impact FCF.

B2C | Accelerating data monetisation, fueling growth

Turning to slide number 8, let me give you some more details for the B2C segment.

Leveraging on a strong set of assets we can grow relevance through a continuous focus on delivering a better customer experience. All in all, a simple quality offer ready for tailor-made personalisation is the base of our value proposal.

Video is a key driver for ARPU and customer loyalty improvement, with IPTV accesses up 17% year-on-year in this first quarter and OTT video service "Movistar Play" being already present in all Hispam countries after its launch in Mexico and Argentina this quarter.

Ultrabroadband speed with price premia increases both satisfaction and ARPU, and its penetration over the total FBB base reaches 63% at the group level, 9 percentage points higher than a year ago.

Mobile data use keeps on growing in both the prepaid segment, thanks to recurrent plans and incentives to top-ups, and in contract, once offers are enriched with new services as data sharing, data transfer or dedicated data for Apps.

Finally, customised integrated handset offers focused on high-value customers' renewals are delivering very positive results.

B2B | Speeding up growth on a sustainable basis

We now move on to slide number 9, where we show how B2B, representing 20% of Group revenues, is speeding-up its pace of growth.

B2B revenues are growing 6% year-on-year on the back of improving trends in both Corporate (+10% year-on-year) and SMEs (+2% year-on-year).

The evolution of the B2B portfolio around a "digital core" of communications, cloud and security services, with building blocks of best-in-class portfolio of own and third parties' digital services, deliver strong revenue performance mainly in Advanced Digital services.

Set on the best networks, the B2B proposal evolves towards customer centric E2E solutions with operational excellence; let me just highlight Cloud & Security services and our virtualized IoT platform, widely awarded and considered as an industry reference.

Best platforms; improving customer relationship & operations

Moving to slide 10,

In the first platform we already cover 85 million premises with UBB and 78% of population with LTE, 95% in Europe, with an efficient network that enabled CapEx needs decrease by 40%.

Network virtualisation with UNICA was deployed in 10 countries and up to 66% of processes are digitalised and managed in real time, while 30% of customers migrated to full stack.

The third platform provides an enlarged offering with digital services revenues growing by 21% in the first quarter leveraging on personalization in the residential business and becoming the best partner for the enterprises' digitalisation process.

The fourth platform enriches all the above with artificial intelligence and open platforms. New functionalities are available in Movistar Home, and more use cases with Big Data and Data Analytics facilitate our decision making process.

Digital Transformation | Progressing as planned

On next slide we show how we are advancing in our Digital transformation program, pushing for further efficiency gains.

As such, the execution of the several initiatives set around sales, customer service digitalisation and process automation is translating into a higher use of digital channels, better customer experience and additional savings to the ones captured in 2018.

In terms of organization, we are taking a step forward evolving into a simpler, more agile and flexible way of working with the Agile Mindset methodology.

As a result, we are progressing well on track and already capturing at the end of the first quarter 20% of the targeted savings for this year of more than 340 million euros.

I now hand over to Laura.

Laura Abasolo – Chief Financial and Control Officer

Spain | Growing share of value within a rational market

Thank you Ángel.

On slide 12 we start reviewing the performance of our Spanish operations, which again show growth in share of value thanks to our premium-quality differentiated offering.

Within a period of tariff upgrades, which tend to impact commercial trading, we continue improving our customer base mix, growing in convergent, TV, FTTH and mobile contract during the quarter. Furthermore, trading for all our value accesses has improved throughout the quarter, with March showing the best monthly data in the period. We have recently announced the launch of new commercial initiatives for the coming months (such as a “Priority” customer care service, or broadband for 2nd homes to our Fusion clients) which should help to carry on with our “More for More” strategy in convergence.

It is worth highlighting that Telefonica España is growing its share of net adds in Spanish fiber. Putting together retail and wholesale customers, Telefonica España share in fiber net adds during the first quarter stands largely above its overall market share, with uptake growing significantly in wholesale, to a combined take-up of more than 26% in Q1 18. This brings in visibility and sustainability to our business.

Spain | Improving revenue and OIBDA trends

Moving on to slide 13, service revenues grew by 0.8% year-on-year in the quarter, above the 0.6% growth seen in the previous quarter. This is the seventh consecutive quarter of service revenue growth at Telefonica España, quite a remarkable achievement.

Within a quarter of lower price increases than those seen in the same period last year, consumer revenues stayed flat year-on-year. An improving mix of customers and promotions' expiry as from Q3 should continue driving B2C revenue growth this year. B2B revenues increased by 3.0% year-on-year, growing for 4 straight quarters already, whilst “Wholesale & Other” revenues start showing a reverse in trend, once drags such as MTR cuts and MVNO agreements start to be removed. We should expect this trend to turn even more evident in the second half of the year.

OIBDA performance improved by as much as 3 percentage points from the previous quarter. As we had anticipated, negative content one-offs seen in Q4 have been removed, and incremental savings (in personnel and digitalisation) allow to partly offset growing content costs. Again, we should expect better margin outlook in the second half, once top-line trends improve and content comparison base eases.

Lastly, worth mentioning Telefonica España remains a benchmark in CapEx/Sales at 12.1% in Q1, despite phasing impacting CapEx 9.2% year-on-year growth.

Germany | Strong trading performance

Moving to slide 14, Telefónica Deutschland posted a strong commercial quarter. The Company has launched new value-added initiatives improving ARPU and churn. The O2 Free portfolio continues to drive usage and ARPU growth leveraging our improved network.

On Tuesday, we also announced a significant enhancement of our infrastructure portfolio with the addition of cable wholesale access through a long term agreement with Vodafone. This deal is subject to the completion of Vodafone's acquisition of Unitymedia.

Telefónica Deutschland registered 306 thousand contract net additions, 94% up year-on-year. O2 contract churn improved 0.2 percentage points year-on-year. O2 contract LTE customers accelerated their average data usage to 4.2GB per month, up 52% year-on-year.

It is worth highlighting the sustained revenue growth of 0.7% year-on-year mainly supported by another quarter of strong handset sales, up 12.6% year-on-year. The OIBDA year-on-year trend has improved 3.8 percentage points compared to last quarter.

CapEx in the quarter strongly increased by 28.3% year-on-year mainly due to front-loaded LTE roll-out, a trend expected to normalise over the year.

UK | Customer centric approach drives growth trends

Telefónica UK continued delivering good growth in its main financials and overall customer base.

The company maintained its market leading position as UK's favourite mobile network, increasing the O2 contract customer base by 4% year-on-year and improving churn to 0.9%. It is also worth highlighting that O2 has been recognised as "Best Network Performance" at Mobile News Awards and "Best Sponsorship of the last 25 years" for "The O2" at the UK Sponsorship Awards in March.

Revenues were up 5.3% year-on-year, mainly driven by the continued success of its flexible tariff offerings, high value handset sales and other revenues, which also supported OIBDA growth of +3.4% year-on-year.

The Company continued to invest efficiently in network capacity and customer experience, and operating cash flow showed a strong improvement of 5.8% year-on-year.

Brazil | Delivering profitable value growth

On slide 16 we can see how our more-for-more strategy is reaping benefits in our Brazilian operations, where we are delivering profitable value growth.

First, and as regards the mobile business, we have implemented different price increases during the last few months, starting with pure postpaid and hybrid in the last few months of 2018, and following with some rises in prepaid packages during March and April. This, coupled with a better base' mix (contract ARPU is as much as 4x higher than that of a prepaid customer) feeds through to mobile ARPU which grows by 2.6% year-on-year in the first three months of the year.

As for the fixed business, we continue speeding-up our transformation journey seeking for a major ARPU increase. We have already passed 9m homes with FTTH, 2m homes already connected, which allows FBB ARPU to post as much as 14% annual growth in the quarter (fiber ARPU is 1.4x higher than XDSL).

We already offer our IPTV service in all cities with FTTH (130 vs. 121 at the end of Q4), which should be of further driving force to future revenue growth: IPTV ARPU is some 20% higher than DTH ARPU.

Brazil | Confirmation of top-line improvement

Next slide shows that our strategy of seeking profitable value results into improving top-line trends. Service revenue trend improves again, mostly due to strong growth in contract (at +8.2% in the quarter vs. +6.9% in Q4 18) which leads to total mobile service revenues growing by 1.6% year-on-year, a marked improvement from the flat performance seen in the last quarter of 2018.

In fixed, a growing weight of high value accesses (Fiber and IPTV) help to further offset declines in traditional voice, which coupled with sequentially improving B2B revenues help our Brazilian operations total revenues to show a significant sequential improvement.

As regards profitability, and no matter we have been expanding margins for the last 9 consecutive quarters, we have been again able to beat inflation (OpEx grows by 2.3% year-on-year which compares with 4.6% inflation rate) and show 0.5 percentage points annual improvement in our OIBDA margin.

South Hispam | Better revenue trends

Moving on to the review of our Hispam operations, and starting with South Hispam on slide 18, we would highlight revenue trends acceleration in the quarter, driven by positive mobile contract net adds for six straight quarters with stable OIBDA evolution despite salaries' catch-up taking place in Argentina during the period.

Our revenues increased by 15% year-on-year in organic terms, with Argentinean revenue growth accelerating on tariffs' increases and Peru showing better year-on-year performance than in the previous quarter. In the latter we have recently launched our convergent offer "Movistar Total", the first and only truly convergent option in the market, which is showing promising results so far.

OIBDA shows similar growth rates than seen in the previous quarter even despite salary catch up in Argentina, on efficiencies and lower subsidies in Chile and Peru.

North Hispam | Top-line turns around

As for North Hispam on next slide, negative revenue trend has been reversed in this first quarter of the year, thanks to Colombia accelerating its top-line growth rate, the good performance seen in Central America, and revenues in Mexico growing by 1.2% year-on-year (first time in 5 quarters) on the back of ARPU improvement and lower regulatory impact vs. previous quarter.

OIBDA performance is nevertheless penalized by a change in the booking criteria of spectrum fees and regulation in Mexico. Should we exclude those dragging effects OIBDA would have maintained similar year-on-year trend vs. the previous quarter.

Telxius | Reaping the benefits of premium infrastructure

On slide 20, we see how Telxius premium infrastructure continues bearing fruits.

75 new towers have been added to the portfolio in the quarter -mainly in Spain, Brazil and Perú- with the tenancy ratio increasing to 1.37 times from 1.34 times in March 2018.

Revenues and OIBDA were positively impacted by the sale of exceptional capacity in the Marea submarine cable, that connects Spain and the United States. Excluding this impact, top-line and OIBDA would have grown by 6.0% and 9.1% year-on-year respectively, sequentially improving in both cases.

On the other hand, CapEx declined more than 80% from the first quarter of 2018, after the completion of the Brusa and Marea cables that came into service last year, driving operating cash flow up by 2.9 times higher excluding the one-off aforementioned.

One more quarter of material debt reduction

Let's now move to balance sheet metrics on slide 21.

One more quarter, we continue to progress on our deleveraging path, relying on strong FCF generation that stood at 1.4bn EUR in the period and comfortably allows to cover all our commitments and continue bringing down debt, which is reduced by €0.7bn in this first quarter, continuing with previous years trends.

Should we include post closing events, net debt would come down by €2.4bn, bringing total net debt figure down to €38.7bn at the end of the quarter.

Hybrid liability management exercise had a temporary effect on debt reduction coming, mainly, from the positive effect of issuing hybrids in excess of the amount of hybrids repurchased. Overall, the two hybrid liability management exercises since March 2018 will reduce our annual hybrid coupons by more than €70 millions.

Finally, let me mention that under IFRS 16 net debt would be impacted by 7.4 billion euros worth of leases, within the low end of the range provided in February 2019.

Strong liquidity thanks to attractive long-term financing

Slide 22 shows how Telefonica keeps on increasing its financial flexibility through actively accessing debt capital markets, including the issuance of the first green bond in the telecommunications sector worldwide during the quarter, with over 5.3 billion euros long-term financing completed year to date in 2019.

By issuing long tenors, we extended our average debt life in excess of 10 years, while keeping a comfortable liquidity position over 24 billion euros, that exceeds next two years of maturities.

And all this happened whilst lowering our interest payments effective cost to 3.39% as of March 2019, 18 basis points lower than in March 2018.

FX impact neutralised at FCF

Moving to slide number 23, we share more details with regards to FX impact on our results.

FX headwinds in the first three months of 2019 dragged close to 5 percentage points to the year-on-year variation of revenues and OIBDA. Argentinean peso and Brazilian Real are the currencies that depreciated the most during the quarter.

This negative effect of 180 million euros at the OIBDA level translated into just 74 million euros in FCF terms, once capex and tax payments in local currency largely mitigated the impact.

As regards net debt, in the 12 month rolling period to March 2019, FX had a small positive impact.

Meanwhile, organic contribution to the reported figures continued to be very solid on a yearly basis.

I will now hand back to Ángel.

Ángel Vilá – Chief Operating Officer

Wrap-up | Solid start of the year

Thank you Laura,

To summarise,

First, today's results showed a solid start of the year, advancing in our strategic positioning and delivering a consistent, profitable & sustainable growth, demonstrated with the strong improvement in revenue growth trends.

Second, double digit Net Income and EPS growth

Third, we further deleveraged, de-risked our balance sheet and improved returns with asset sales. We have brought down net debt by 8 straight quarters.

Fourth, best-in-class infrastructures continue to be key for ensuring top quality customer experience.

Fifth, monetisation of the core and the extended offering along with digitalisation efficiencies are translating in higher efficiencies.

This allowed us to confirm the outlook for 2019 and to continue returning value to our shareholders through our proposed 0.4€ dividend per share.

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

Q&A session

Mathieu Robilliard – Barclays

I had two questions. First, on Spain, in terms of the different revenue dynamics. So I think wholesale did a bit better probably than what you were flagging at the end of last year, so if you could explain the different moving parts there. And when I look at consumer, do you think that the recent initiatives that you announced, I'm talking about for example the premium service called "Priority" and other ones can have a contribution that is meaningful to the top line already in 2019?

And then I had a question on Brazil. So obviously, improved mobile performance there, but when we look at fixed, despite all the investments that you're doing, it is still tough in terms of the KPIs and there's more competition from small players in different areas. Is this a business line -I'm talking fixed Brazil- that you think can revert to growth or stabilization in the short term or is it more delayed?

Ángel Vilá – Chief Operating Officer

On Spain revenue dynamics, you have seen that we are posting revenue growth again, and service revenue growth for 7 quarters in a row. This is consistent with what we have been expecting and communicating in the previous conference call. The components here:

- On B2C which accounts for a bit more than 50%, actually 55% of service revenues, it has a flat performance in the quarter mainly due to the different phasing of price or tariff upgrades in this first quarter of this year compared to the first quarter of last year. And also due to a more muted commercial performance in the quarter.
- At the same time, B2B, which accounts for 28% of service revenues, growing 3% for the fifth quarter in a row. Here, I would like to highlight the very strong growth of IT at 18.5% which more than offsets the decline on the traditional communications part, and this is due to all the digital services efforts that we are doing in B2B not only in Spain but all across the footprint.
- And third, the component of wholesale and others which accounts for 17% of service revenue, it has turned around and is growing at 0.2% in this quarter. The reduced impact of MVNO loss and the regulatory impacts that we saw last year are absorbed by growth in NEBA and TV and roaming revenues. We think and we have been expecting this turnaround of the trend. It is true that in the previous call, I got a question whether this would turn to growth, and at that point, we were cautious in projecting forward what could be the trends, but what we have seen in the first quarter, we think that we can continue seeing in additional quarters.

I think you are also asking about commercial initiatives, new commercial initiatives that we are working-in in Spain. This is linked to our more for more strategy, we are enriching the offer that we have for our customers and we are launching different services targeted to improve and increase the engagement of the customers with us, and support more for more strategies. As such, we have been launching services like "Movistar Car" which includes connectivity, SOS, safety, car diagnosis for the vehicles of our customers. We have launched security or services like "Conexión segura", "Movistar Cloud"; services which are quite interesting for families like "Movistar Junior" or "Parental Protection", especially for large families like Pablo's family, I should say. And then we are also giving devices with more intelligence for the home like "Movistar Home". And we are getting into financial services with "Movistar Money". Soon, we are going to be launching also additional services like "priority Movistar", premium service treatment for our more valued customers. And also, we are launching Fusión for second residences which is a segment where we see high potential in Spain; you have to take into account that there are almost 3 million second homes in this country.

Regarding Brazil and the revenue trends in Brazil, what we have seen is an improvement of the top line. This has been driven by a positive acceleration and performance of revenues in mobile, and better trends in the fixed revenues. Here, we are working in a big effort of transformation in those businesses such as voice, DTH, copper which are declining while we're seeing ultra-broadband and fiber growing strongly at double digits. So, the trend that we are seeing quarter by quarter in this transformation of the revenue function of the fixed business, we think, is going to continue in the same direction and probably produce positive results in the future. I don't know if that would address your question.

Ivón Leal – BBVA

The first one is on those announcements launching an OTT offering in Spain in June. I don't know if you could give us a bit more detail on that, because I guess that's a meaningful change in your strategy. So, I don't know if you could tell us about the timing. If I understand correctly, I think everything except football is going to be offered to all of the market, and eventually if that strategy is going to be exported to other countries.

And the second one is on competitive landscape in Spain. ARPU has basically stabilized in the last 2 quarters. This week, we had Euskaltel basically blaming competition for margin pressure, and at the same day, I think MasMóvil was dismissing that. So, would be interesting to know your view on how ARPU is going to evolve in Spain going forward, and how competition has kicked off in 2019.

Ángel Vilá – Chief Operating Officer

Thank you, Ivón. On the first question on the OTT launch that we've announced in Spain, and whether this means a change of approach, the short answer is no, but let me elaborate.

Video remains core for our customers. What we see is that at the core of our strategy of offering, the best Pay TV and the best video, this is delivering good results. We have more than 8 million daily audience, growing 8% y-o-y on Movistar Plus platform, with a daily consumption which is growing sequentially to more than 200 minutes per day. The TV offer, convergent, differential and complete increases loyalty. TV customers have a churn which is 25% lower to non-TV customers. So, TV evolution is key to defend a very strong market position.

At the same time, what we see is a low penetration of Pay TV in Spain, which stands according to different sources at between 35% and 45%, which compares to most other European markets around 60% to even 100% penetration. So, we see a growth opportunity.

So, with these 2 elements, we have announced the launch of our OTT to take place in June at a cost of 8 euros per month. This will include a limited tasting of our content. So, it will include generalist channels produced in-house (Vamos and #0), some limited linear channels; it will include Movistar Series and Seriesmanía, and some video-on-demand of in-house content. It will not include for sure any football, it will not include a big part of our premium and sport offer.

So, it will allow in a rational move to capture a complementary part of the significant growth opportunity that we see in the Spanish TV market. This is an online product, which will be linked to an app download. Its aimed to appeal to a big number of online followers that are following already our content or some programs online, especially those of our own production included in channels like #0. So, we aim to take them as a 1P OTT product, and allow them to taste a preview of the Movistar+ content that will allow us later to attempt to upsell those customers into our full convergent pay TV services.

We see zero cannibalization risk. It does not detract value from our Fusión offering. It does include no football, it includes no functionalities, no add-ons possibilities.

And regarding the competitive landscape in Spain, we think or we see that overall dynamics remain rational and competitive. We had a softer competitive quarter in Q4 following a quite intense Q3, and what we have seen in this first quarter of the year was a quiet beginning of the quarter which showed later higher promotional activity.

Promotional intensity was mostly concentrated in the low end, mainly through extra mobile data allowances and what we saw also, Vodafone in their final quarter of the year, ahead of their full year close, were quite active in promotions. It's not unusual since Vodafone has been for a while the most active promotional player in the market. At the same time, we have seen that market portability continues to slow down and remains in line with the minimum levels seen in 2018, signalling a rational competitive environment.

We see, again, competition intense in the low end including prepaid where we are less exposed, and we expect (having seen that Vodafone's new portfolio offers, which includes some More for More elements), that their promotional activity would cool down and they would focus on their new proposal.

So summing up, we see a rational environment in the high end with value bundles, with ultra-broadband connections, Pay TV services, value-added content and new added functionalities, which it is where we focus and where we still see room for selective More for More. And this is the segment that takes more of our B2C revenues. So yes, competitive and rational at the same time.

Michael Bishop – Goldman Sachs

Firstly, just moving to the U.K. There were some headlines around O2 U.K. potentially looking at fixed line again during the quarter and also most tariffs slowing in terms of the uptake of the convergence as a market. Both Virgin Media and BT yesterday talked about potentially moving forward a bit more with for the converged product, so would like to get your latest thoughts on that.

And secondly, in terms of working capital, I was just wondering whether you can just build on the comments around working capital unwinding through the rest of the year and where you potentially see the direction of working capital for the whole of 2019.

Ángel Vilá – Chief Operating Officer

On the U.K., we think that convergence remains supply-led rather than demand-led. It's not being demanded, and it is not growing at the speed that we have seen in other countries. What we have seen is that the majority of the market remains, or we think remains mobile-focused; being the U.K. one of the highest loyalty markets. Also, the telecom pricing and margins in the U.K. are already leaning towards some of the lowest in Europe. And since convergence to take traction sometimes entails discount to the bundles, we think there is little scope. And also, the penetration of services like pay TV, that allow to build convergent bundles, is already very high in the U.K., so one of the critical elements that we have seen for convergence to take up probably does not have upside in the U.K. as it has had in other places. So, we see convergence still as supply-led, not demand-led and having relatively little traction.

However, of course, market conditions can change. If the convergence segment was to grow, we have already a hedge with one of the largest converged players whose MVNO is on us, being Sky. And there could be elements where we could access to converged plays.

However, I have to say (regarding what has been speculated), that we are delighted with Telefónica U.K.'s mobile first strategy. You can see this has been very effective in delivering top line, bottom line, customer growth, customer loyalty. We made the choice to exit the fixed market in 2013 and we have currently no plans to change this course and this decision that we took already in 2013.

Laura Abasolo – Chief Financial and Control Officer

Regarding working capital, Q1 has had a consumption of EUR -711 million, which is due to seasonality impacts, as it's usually usual in this first quarter of the year, net of working capital measures. The consumption in Q1 has been slightly lower than the consumption of last year. But we will see throughout the year that consumption diminishes with seasonality playing more in favour and continuing with working capital measures. So, for the full 2019 year, we will expect a positive contribution of working capital in our free cash flow. And that's why we commented that this will be unwinding throughout the year, which is usually what happens every single year. So, we usually see this trend.

Mandeep Singh – Redburn

First of all, related to the Spanish sort of fixed line trends and broadband trends. I know you had price increases through and your trading improved sequentially through the quarter, but quite a big line loss number and a decline in broadband subs. So, can broadband net adds return to stability in Q2 and beyond, and also, what's the outlook for line losses, it was quite a big decline in Q1. So, just linking that and how relative to the sort of big content investments you've made, is it surprising to see these sorts of trends given how much better your content offerings are versus everybody else.

And the second question is whether the outlook for wholesale is sort of negative or positive on the basis that, as copper declines, can NEBA growth take the strain for copper declines.

Ángel Vilá – Chief Operating Officer

Thank you, Mandeep, as always a pleasure to talk to you again. On the Spanish trends, and you were asking on the fixed, no? I'm going to deal with the commercial trends because as you know on revenues, we are looking at the bundles in a converged way. I should say that it's not unusual to see softer KPIs in quarter in which we updated tariffs. And we

updated in January tariffs for fixed only, for mobile only, and in February we have updated tariffs for convergence. But, if one looks at the evolution inside the quarter between January, February and March, what we have seen is that an improvement takes once the tariff upgrades effect vanishes, and actually, the month of March as an exit month of the quarter is quite positive. So for instance in convergent we've got 13k net adds of which 13k positive net adds were in the month of March; in mobile contract as well, in TV this happened as well, also in fiber. We expect this trend to continue improving.

As you can see on slide 12, we continue improving our customer base mix. We're growing in convergent, in TV, we're growing in fiber and we are growing in mobile contract. But, more in particular, to what you are asking in fiber, you can also see on slide 12 that we are growing our share of fiber net adds both on the retail side and the wholesale side, and we're also growing the uptake: the number of homes connected to homes passed both on retail and wholesale sides. And on wholesale fiber net adds were 197k.

So yes, it's been a more muted quarter, but we are seeing trends that are supportive of the commercial traction. And in any case, the decline in fixed broadband has been more significant in non-converged than actually in converged. We have launched, as I was talking in a previous question, a new portfolio of digital services. We have strong expectations of commercial traction, and we also see potential for selective More for More moves.

Regarding wholesale, the different moving pieces I also spoke about in a previous question, we have seen, and we are seeing the fading-away of what we had seen adverse moves or impacts from MVNO loss. We see lower impact of regulatory impacts. And then, we are seeing growth in NEBA, we are seeing growth in wholesale TV and we are seeing growth in roaming revenues, which has made the drag that we had in the wholesale line fade away and turn actually to slight positive revenue performance in the first quarter, which, given the trends that we see, I'm more confident now about the sustainability of this performance.

David Wright – *Bank of America Merrill Lynch*

Just a question on Spain and O2, please. Obviously, that is now a contributing factor to convergent revenues. I just wondered if you would be willing to give us any KPIs perhaps for O2, any line adds, what kind of ARPU it is coming in at, just so we can maybe start to model some of the convergent dynamic. It's tempting to just see the convergent ARPU reflecting the Fusión momentum, but now there is a growing dilutive effect from O2 adds. So, I wondered if you can give us any granularity on that, unless I may have missed anything.

Ángel Vilá – *Chief Operating Officer*

Hi David, O2 is progressing according to the expectations that we have for this proposition. It's a way to, without cannibalization, address some segments that were not fully addressed by our converged Fusión bundles. It's reaching some base, around high'50k-60k fixed broadband subscribers, is around 120k mobile subscribers, 80% of those would be converged subs.

In the published converged ARPU we before included only the Fusión ARPU, and now we are including Fusión and O2 ARPU, and obviously also in the mix of converged customers (between high, mid, low-end) we are including the O2 customers. These obviously are leaning towards the low-end and are affecting the ARPU increase that we see year-on-year on converged functions, which I have to say is still a growing ARPU.

In this sense, I would take advantage of your question to point out something, which is the mix of our converged customers. In addition to what we are seeing in the convergent ARPU, a growth year-on-year of 0.6%, we are seeing that in the mix, 30% of the customer base continues to be high-value packages, which is 3 percentage points higher year-on-year; here we're talking about an average ARPU of EUR 130. What we call mid-value, which is 33% of the mix, it's an ARPU of EUR 85, and what we call low-end of converged customers which account for 37% (and this includes the O2 customers) has an average ARPU of EUR 60. Bear in mind that what we call low-end with an average ARPU of EUR 60, is the average ARPU of our closest competitor, which stands at EUR 58.

So, I would like to say that yes, O2 is increasing the mix of what we call low-end; yes, O2 is low ARPU in that category, but what we call low-end ARPU is what our closest competitor calls average ARPU. So yes, O2 is getting traction, but it's not something that is not expected in our projections.

David Wright – *Bank of America Merrill Lynch*

If I can maybe just follow up, given those broadband subs, I guess it launched late last year, I'm just trying to understand what the sort of net adds O2, which could imply a slightly higher net loss perhaps in the Fusion base. Will that be right or is that not really the way to read this?

Ángel Vilá – *Chief Operating Officer*

Well, what we're seeing is that portabilities from Movistar to O2 are quite reduced. More than 85% of the capture of O2 is not from us.

Jakob Bluestone – *Credit Suisse*

Firstly, just on your guidance and how you're sort of tracking against that. You're guiding for about 2% EBITDA growth for the full year and you did about 1% in Q1, and just trying to understand which are the bits you expect to accelerate during the course of the year. You obviously cite Spain gets better later in the year, but what I wanted to understand is: is that what is really driving that implied acceleration during the course of the year, or are there other parts of the business as well that you think will pick up in terms of EBITDA growth during the course of 2019? That's the first question.

And then secondly, just to follow up from David's question, as you highlighted, there are two bits driving your Fusión ARPUs, one of them being this mix effect and on the other side has been putting through various price hikes, but I guess sort of the evolution of convergent ARPU is just really the balance of those two. I mean, is it fair to say that the mix effect is becoming bigger? So, can we start seeing convergent ARPU decline from here, just because more and more of what you referred to as the low-end becoming a sort of bigger share of it, or do you think convergent ARPU is still continue to grow because the pricing power that you have?

Ángel Vilá – *Chief Operating Officer*

On the guidance, we have guided for OIBDA growth around 2% for the year. And in the first quarter, it's growing around by 1%. We expect group OIBDA growth to accelerate along the year with better growth in the second half versus the first half fostered by several factors.

Spain is one that we've been flagging with reiteration in previous calls. We expect service revenue acceleration in the second half fostered by the end of football promotions, by IT revenues acceleration, new B2C digital opportunities, (that I was talking about in a previous question), and the wholesale revenues acceleration. In addition to revenues, the lower year-on-year growth in net content costs in the second half, and further efficiencies in areas like commercial channels, call centers, network, IT costs from digitalization and automation. So, Spain is a clear area.

We are also expecting better performance in second half in OIBDA in other geographies: Germany, according to their own guidance as they stated in their call yesterday; Brazil, as was also stated in their call yesterday; and what we see is that the drags that we have seen in Hispanoamerican units are to be lower also. So, we remain confident and reiterate our guidance of OIBDA growth around 2%.

Regarding Fusión ARPU, we are not expecting to see a decline going forward. In the first quarter, Fusión ARPU increased 0.6% year on year from EUR 87.8 to EUR 88.2. To explain this improvement, it had a positive impact from tariff upgrades, positive impact from upselling, and dilutive impact from promos, mobile add-ons migrating to Fusión multiline packs and from convergent offers in the multiline segment, as I spoke about regarding O2. We see potential for additional selective "More for More" moves in the market, especially in the high-end, and we are launching new commercial initiatives where we aim to improve engagement, or further improve I should say, the engagement with our customers which make us being confident that the positive convergent ARPU evolution should be here to stay.

Carl Murdock-Smith – *Berenberg Bank*

Just following on from Jacob's question asking on the other side of the convergence KPIs. I suppose taking a longer term view of convergent churn (5 years ago it was at 1.1%, now it's a 1.7%), given the strength of your brand, the improvements you've made on mix and proposition, I suppose it's quite as a promise of the 5 year period and just kind

of taking a longer term view, do you think that churn will now stabilize at that kind of level, or looking forward 5 years, would you expect, given the increasing competition in the market, that convergent churn, as you push through the penetration, will still continue to trend up over the years to come?

Ángel Vilá – Chief Operating Officer

Thank you for your question. First, I would want to state that converged products being a bundle of several products, once there is a move in any of the products that make part of the bundle that is accounted for as churn, that doesn't mean that the customer churns, but it could be that the customer drops some product or some part of the bundle.

Second, for the last quite few quarters, churn has been moving in a relatively stable band around 1.5% - 1.6%. Yes in this quarter, we've seen a slight spike to 1.7%. But we think that this is within a controlled range. As you should imagine, this is one of the KPIs that we measure very carefully within our commercial moves and marketing moves in the converged world. So, we are looking at the number of converged customers, their ARPU, the mix and the churn. And this is something that if we see any deviation that would be concerning, we can clearly adjust our propositions in order to manage the situation, which at this point, we do not think that should be of concern.

Carl Murdock-Smith – Berenberg Bank

So, in response to Jacob's questions, you said that you thought convergence ARPU will go up; are you willing to say that you think that convergent churn can stabilize around this level, or should I expect it to trend upwards on a kind of multiyear view?

Ángel Vilá – Chief Operating Officer

We would expect Fusión churn to move in a band around these levels but not to spike up.

Jeremy A. Dellis – Jefferies

First one has to do in Spain. In Spain, your Pay TV intake this quarter was about 4k, Q1 last year was about 80k. Recently, you revamped the Fusión line-up to segment, in particular, the football content in a different way; I think Netflix also became available as an upsell for Fusión customers from December onwards. To understand the TV dynamic would be interesting, please. And also, to understand whether the promotional pressures that you were seeing during the first quarter have extended into the sort of the first half of the second quarter as well.

And my second question has to do with the U.K. you reported a mobile service revenue growth rate of positive 0.5% today. And previously, as you reported on a different basis, the mobile service revenue trends that we had previously were on an IAS 18 basis, but you reported growth of 2.8% in Q4 and I think about 3.5% in Q3. Is the slowdown between the revenue growth rates that were reported previously and the one you reported today is that purely an accounting effect? Is it possible to get any pro forma sense of what the underlying development in U.K. revenue trends has been, please? Thank you.

Ángel Vilá – Chief Operating Officer

Thank you for your questions. Regarding Spain Pay TV, we continue to see an opportunity in the market. We see that penetration is still low compared to other markets. What we're also think is that this has to be a segmented approach. The number of net adds varies along quarters depending on factors, for instance, the start of the sport season, so the same way that you saw in Q3 last year an important push ahead, one would expect another similar type of movements in the third quarter this year. The difference of this first quarter versus last year is that 1 year ago we included TV in some packages that were not having some contents before and didn't have TV, that made a jump in the first quarter last year which has not been repeated this year. Regarding the promotions, what we see is less intensity of promotions on some players that have moved to innovative approaches such as Vodafone, more based on speed and less working on promos albeit we don't think it is disruptive, and maybe tactically some other players may be doing some promotions.

Now, who saw lower commercial performance in the first quarter, potentially Orange could be promoting a bit. But this is not unusual, this is regular dynamics that we see in the Spanish market.

Regarding the U.K., we continue to have a strong revenue performance. Revenues have grown in the first quarter 5.3%. This is driven by the continuing success of flexible tariff offerings like Custom Plans. Also, traction on handset sales (of value handset sales), and we continue to have revenue growth in other segments like in the SMIP IoT elements, in MVNO and in business ICT. Here, when one looks at the revenue function in the U.K., the split between mobile service revenue and handset sales has been affected by IFRS 15 and accounting between these 2 elements. That's why one should look at the total revenue rather than these 2 components. There have also been some elements such a decrease in out-of-bundle traffic (once bundles become larger, you have lower out-of-bundle traffic), and some slowdown in interconnect and outbound roaming. But we see that we continue to have strong total revenue trend in the U.K., and we expect to continue outperforming the market. At the same time, we are displaying the benchmark churn in the market of just 0.9%.

Fernando Cordero Barreira – Santander

The first one is regarding Latin America. In that sense, we have seen mobile network sharing deals here in Europe in the recent weeks and I would like to know at which extent, which would be your thoughts, particularly thinking in Latin America, at ahead of the potential CapEx cycle that would come from 5G.

The second question is related with your balance sheet. And at which extent, after seeing the disposals of Central America businesses as well as the disposal of some of your data center assets, I'd like to know how far are you from your desired capital structure in terms of leverage or should we expect any further asset disposals?

Ángel Vilá – Chief Operating Officer

I'll take the first question and of course, Laura the second one.

On network sharing, we are firm believers in network sharing. 80% of CapEx and 20% of OpEx in network are due to infrastructure; sites, transmission, rentals... So, network sharing is an opportunity to reduce network costs, while maintaining the objectives of coverage and quality and therefore improve the return on capital employed which is a critical objective for us and I would say should be for the industry. We think that this will be especially relevant in the upcoming deployment of 5G technology due to the pressures coming from a much denser network both in radio access and in transport.

We're already sharing in several of our geographies. You asked specifically for Hispanoamerica or Latin America, but we're sharing in many of our geographies where we have sharing of infrastructure, of transport, of fixed access, of mobile access, in different degrees and different flavours in different countries. We have sharing of infrastructure in Brazil, in Argentina, in Chile, also in Colombia very significantly with Tigo. We have sharing of transport as well in mobile, which is where you're focusing. Already we have some experiences of 3G, 4G RAN sharing with OI, with TIM and with Claro. In Argentina, we are sharing 3G and 4G with Claro in some cities. And we have signed an agreement also in Colombia with Tigo and in Central American assets (that we are now in the process of divestment) we have also shared agreements with Millicom.

Willingness to explore sharing in 5G, of course, without any doubt. But it takes two to tango. So we'll approach partners in due course. It's early days for 5G and especially in Hispanoamerica, but yes, we are ready. We recently announced in the U.K. the extension of our sharing agreement with Vodafone to 5G, and we will explore opportunities, if they create value and they do not erode our competitive position, in every other geography.

Laura Abasolo – Chief Financial and Control Officer

Thank you, Fernando for your question. It is worth mentioning that after the disposals of Central America and the data centers, we have accelerated the net debt reduction substantially. Today, we are at EUR 38.7 billion after post-closing events. Let me highlight the evolution because we have decreased EUR 2.4 billion just since the beginning of the year. And if we look at since June 2016, we have almost reduced our net debt by EUR 14 billion in 11 quarters. That's more than EUR 1 billion per quarter, and that has been done on the back of many levers. The most important being a strong free cash flow coming from operations but also optimization of our tax and interest payments and inorganic measures.

As you mentioned, we are return on capital driven despite having a very strong CapEx intensity these past years and also despite having spectrum payment every single year. From that point, our intention is to continue reducing debt and leverage going forward on the back of a strong cash flow generation, and we could consider inorganic measures always based on return on capital employed and with no need to sell anything in a rush that does not create strategic value.

I definitely think we are approaching the moment when net debt will be less of a concern for the investment community and that gives us flexibility, but I also want to say that we are fully committed to maintaining investment grade credit rating, and we will keep taking debt down organically and also inorganically.