

*Telefonica*

# Results

January - September 2014

Investor Relations  
Telefónica, S.A.



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# Key points for the third quarter

- **Strong operating momentum gaining traction**
  - ▶ Boost in strategic areas (fiber, Pay TV, mobile contract -smartphones & LTE-), increasing customer value and reinforcing leading position amid sustained competitive pressures
  - ▶ Best ever quarterly net adds of smartphones and fiber customers
- **Ramp-up in Q3 revenue growth (+2.8% y-o-y); generating sustainable expansion**
  - ▶ Enhanced revenue trends across most markets
  - ▶ OIBDA back to growth (+0.8% y-o-y) and sequential margin expansion to 32.8%, limiting erosion to 0.6 p.p. y-o-y
- **CapEx intensity for a scale All-IP Company and to drive customer growth**
- **High cash generation profile & Robust balance sheet**
  - ▶ 9M FCF €2.8Bn; FCFS €0.63
  - ▶ Net debt at €41.2Bn as of Sep-14; E-Plus acquisition to be reflected in Q4
- **Value enhancing deals; reinforcing competitive edge in main markets**
  - ▶ E-Plus closed; GVT underway
- **Results up to September fully aligned with expectations and year-end guidance. Dividend reiterated**
  - ▶ 9M: Revenues +0.4%; OIBDA margin erosion -0.7 p.p.; CapEx/Sales 14.4%; all organic y-o-y and ex-Venezuela

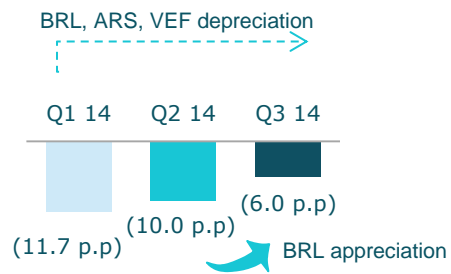
All y-o-y changes are organic

# Financial highlights

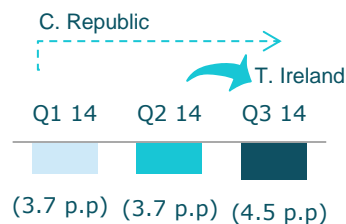
€ in millions	9M 14			Q3 14		
	Reported	Reported y-o-y	Organic y-o-y	Reported	Reported y-o-y	Organic y-o-y
<b>Revenue</b>	37,978	(10.9%)	1.9%	13,021	(7.4%)	2.8%
<b>OIBDA</b>	12,325	(12.6%)	0.2%	4,269	(8.7%)	0.8%
<b>OIBDA Margin</b>	32.5%	(0.6 p.p.)	(0.5 p.p.)	32.8%	(0.5 p.p.)	(0.6 p.p.)
<b>OpCF (ex-spectrum)</b>	6,779	(25.3%)	(14.4%)	2,057	(24.5%)	(16.4%)
<b>Net Income</b>	2,849	(9.4%)	---	947	(13.0%)	---
<b>EPS</b>	0.61	(12.9%)	---	0.20	(16.6%)	---
<b>FCF</b>	2,839	(16.5%)	---	1,175	(39.7%)	---
<b>Net financial debt</b>	41,200	(10.6%)	---	41,200	(10.6%)	---

## FX headwinds starting to ease in Q3 14; changes in perimeter from Q4 14

### Forex impact OIBDA (y-o-y)



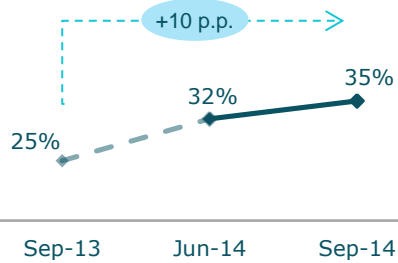
### Perimeter impact OIBDA (y-o-y)



**FX effect mitigated at FCF level as lower CapEx, Interest, Tax & Minorities payments offset OIBDA impact**

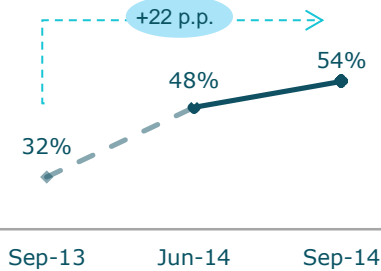
# Stepping-up investments already fostering high value growth

## Smartphone penetration



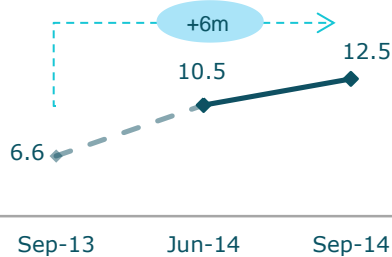
**Q3 Net adds**  
8.5m (1.6x q-o-q;  
2.0x y-o-y)

## LTE coverage (Europe)



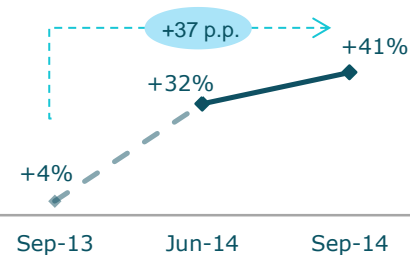
**LTE launched in 7 T.Hispam markets + Brazil**

## FTTH premises passed (m)



**Q3 Net adds**  
265k (1.3x q-o-q;  
1.8x y-o-y)

## Pay TV accesses (organic y-o-y)



**Q3 Net adds**  
458k (4.0x y-o-y)

## Growing demand for fiber, LTE, Pay TV and smartphones

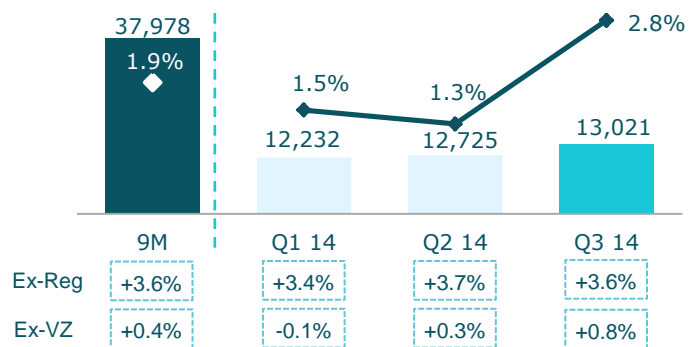
- Further **ramp-up in fiber net adds momentum** to 1.4m connected accesses (x2.1 y-o-y)
- **Pushing LTE**; primary catalyst of data monetisation
- Launch of new devices driving **smartphones net adds**
- **Pay TV gathering momentum**

## Building loyalty

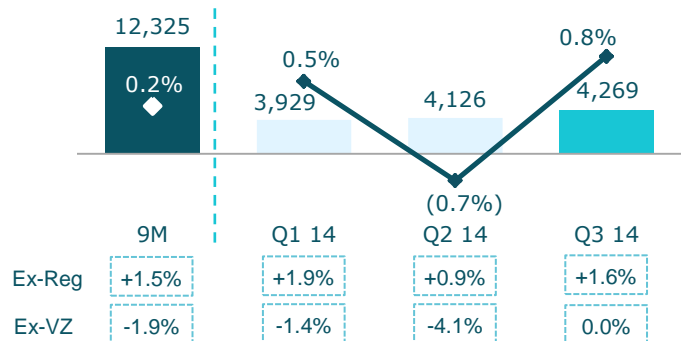
- **Almost-flat Q3 churn** y-o-y and q-o-q
- **Competitive tariffs**; bundling strategy
- **Upselling opportunities** through new technologies, digital services and shared data plans
- **Customer insight** for optimising our offer

# Q3 improvement across the board (% and absolute)

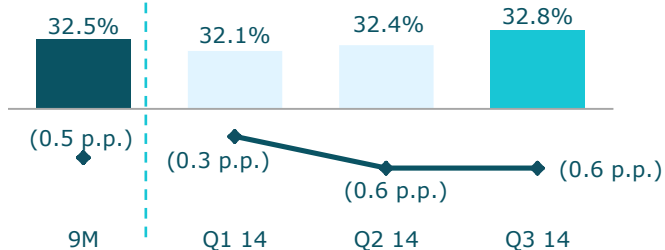
## Revenue (organic y-o-y)



## OIBDA (organic y-o-y)



## OIBDA margin (organic y-o-y)



All y-o-y changes are organic

## Attractive growth profile

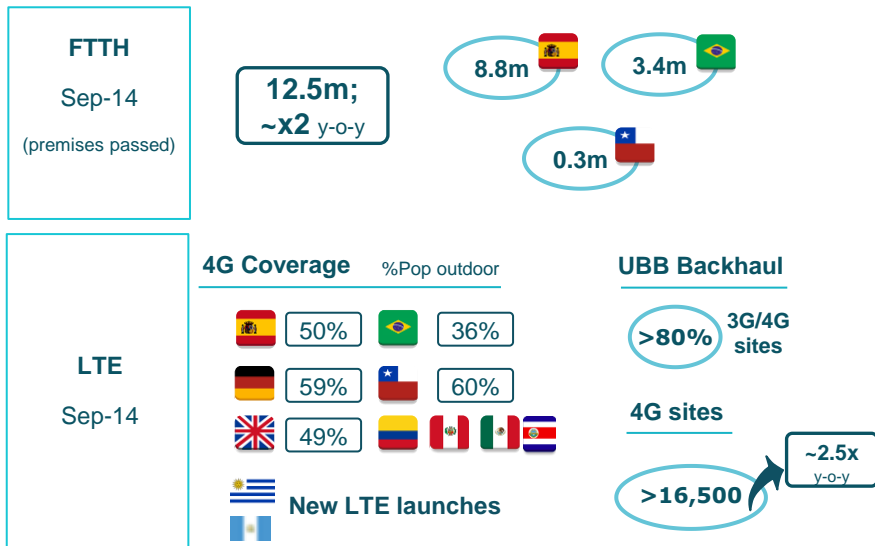
- **6 consecutive quarters of y-o-y revenue growth**
- **Accelerating revenue trends in Q3; +1.5 p.p. q-o-q underpinned by**
  - ▶ Decline slowed-down in Spain (+2.5 p.p. q-o-q) to -6.6% y-o-y
  - ▶ T. Hispam improved +2.8 p.p. to 14.1% y-o-y
- **Continued mobile data strength (Q3: +11.1% y-o-y) improving revenue mix towards a more data & digital Company**
  - ▶ Non-SMS data sales accelerating to +25.3% y-o-y in Q3 (+1.3 p.p. q-o-q)
  - ▶ Mobile data/MSR 40% (+3 p.p. vs. Q3 13)
  - ▶ Growing sales of digital services: >20% y-o-y in 9M

## Profitability up sequentially as revenue flows

- **OIBDA returned to positive growth (flat ex-Venezuela)**
  - ▶ Improvement of 1.5 p.p. vs. Q2 y-o-y despite very high level of commercial activity
  - ▶ Supported by cost efficiencies, synergies and scale
- **Retained healthy margin at 32.8% in Q3** (contained erosion of 0.6 p.p. y-o-y) even in a context of intense commercial efforts and higher CapEx to lead network modernisation
  - ▶ Q3 Commercial costs up 9.4% y-o-y (+3.4 p.p. q-o-q)
  - ▶ Growing network & IT costs +11.3% y-o-y in Q3 (+4.0 p.p. q-o-q)

# TGR: Strengthening differentiation

## Network: UBB developments



## Operational excellence

- Sustained differentiation**

  - LTE-A already available in Spain (up to 300Mbps)
  - Network technically **fully ready for VoLTE** rollout in Germany
  - **700Mhz 4G spectrum awarded in Brazil**
- Leaner operations**

  - **OSS Transformation:** promoting standardised, simple and optimised global OSSs and processes
  - **Reference Lab for NFV<sup>1</sup>**
  - **E2E customer equipment management:** higher standardisation, less costs

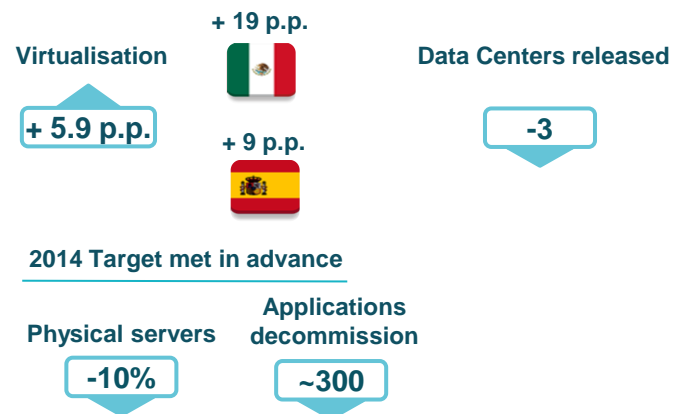
## IT: continued progress towards Brilliant IT & Simplification

- Transformation to Digital Telco**  
(unify and recycle)

  - Full Stacks projects driving business transformations in Argentina and other countries in T. Hispam
  - **Global convergent Datawarehouse:** maximising simplification, standardisation and more powerful Business Intelligence
- Enhancing online customer capabilities**

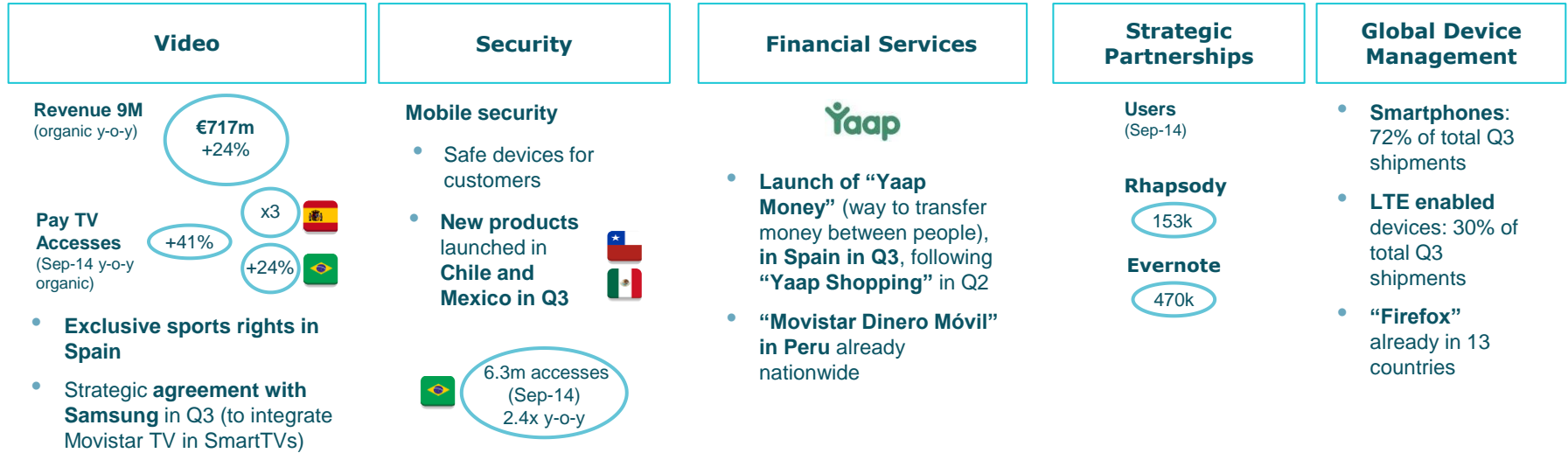
  - **Spain:** new customer online channel (fully convergent)
  - **Brazil:** full digitalisation of order management; launch of first online customer care
  - **HispAm:** unified e-commerce solution in 8 countries

## KPIs (YTD)

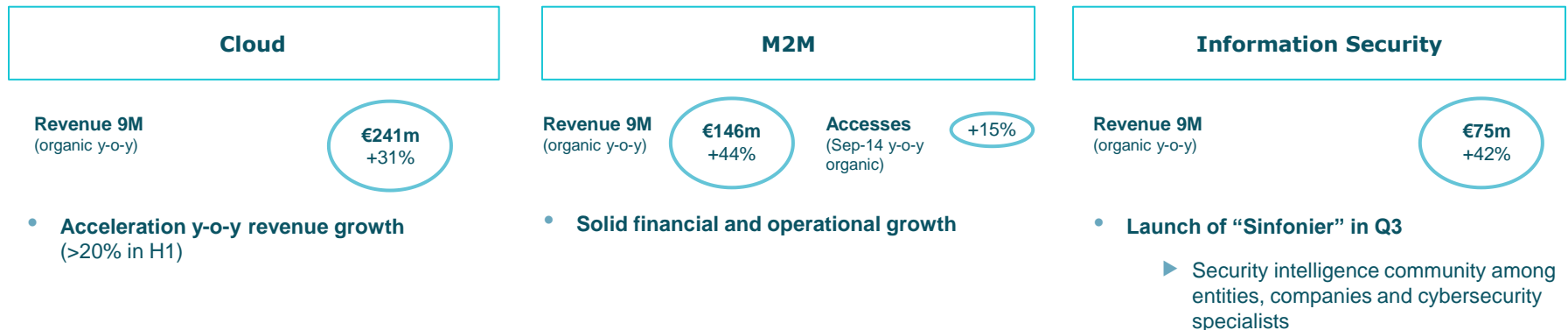


# Digital Services: Enriching our digital solutions portfolio

## Consumer: Differential customer propositions



## B2B: Solid performance on the back of our B2B services enhancement

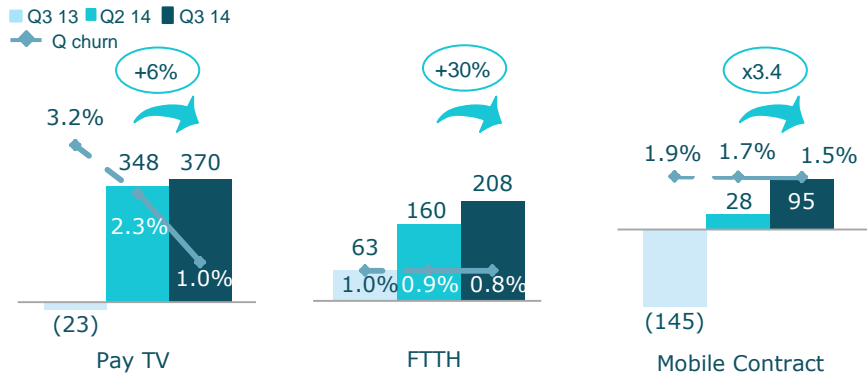




# Spain: Gaining momentum on differential quality

23% of Group revenue

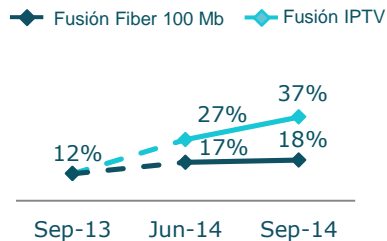
## Net adds ('000)



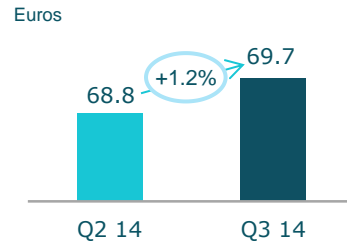
## Trading acceleration despite summer seasonality

- Pay TV: key engine pushing convergence**
  - 1.6 m customers (x2.6 y-o-y); 32% market share<sup>(1)</sup> (+17 p.p. y-o-y)
- FTTH customers surpass 1 m (x2.2 y-o-y)**
  - 886K Fiber 100Mb:10€/month premium; 0.5x churn vs.DSL
- Mobile contract turnaround stabilises the base**
  - Best quarterly net adds since Q2 11
  - Mobile contract customer base -1% y-o-y <sup>(2)</sup>

## High value in "Fusión"



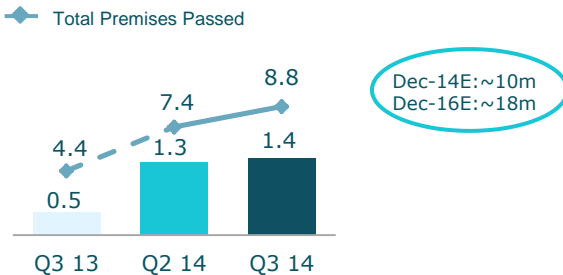
## "Fusión" ARPU starts to grow



## Leading convergent platform

- Portfolio upgraded** in Q3 adding value: mobile data and VAS
- 3.6m "Fusión" customers (+39% y-o-y); 1.4m mobile additions (+34% y-o-y)**
  - 476k repositions on "Fusión TV" in Q3
- Increased customer value:** "Fusión" churn in Q3 1.0%
  - Longer lifetime vs.stand-alone: 2.2x FBB & 2.5x mobile contract
- Rapid growth of high-value services**
  - 67% "Fusión TV" gross adds  $\geq$ €60 (+6 p.p. q-o-q)

## FTTH New premises passed (m)



## UBB deployment speeding-up: scope and quality

- FTTH: infrastructure differentiating lever**
  - Highly complementary with premium TV contents
- LTE coverage:** 50% pop. in Sep-14 (Dec-14E~60%)

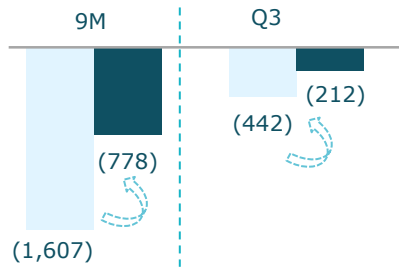
(1) Internal estimate  
(2) Excluding the disconnection of inactive M2M accesses

# Spain: Top line improvement acceleration

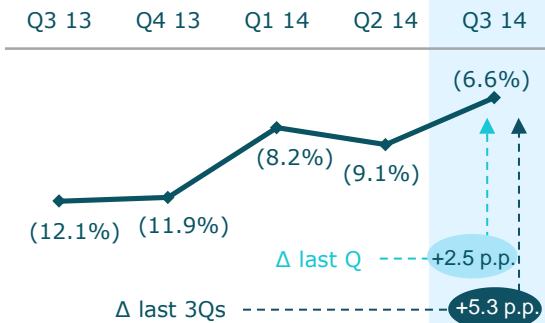
23% of Group revenue

## Revenue y-o-y (€ in millions)

■ 2013 ■ 2014

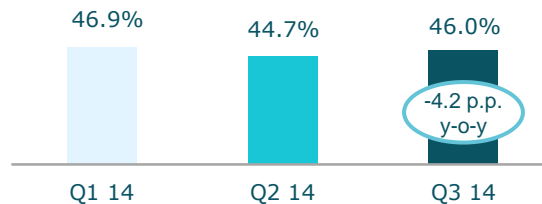


## Revenue y-o-y (%)



## OIBDA margin

○ y-o-y



## Commercial turnaround starts to pay off

- **Strong trading reflected in better top line performance**
  - ▶ Revenue y-o-y drop halved in the last 3Qs
  - ▶ Quarterly revenue stabilised: ~€3bn in the last 3Qs
  - ▶ Backbook repricing fading off (high convergent base)
    - 70% consumer FBB
    - 75% consumer mobile contract (including 2013 mobile tariffs)
- **Revenue stabilisation more visible going forward**
  - ▶ Accesses (FBB, FTTH, Pay TV, mobile contract) are stable or growing y-o-y
  - ▶ “Fusión” ARPU already growing
  - ▶ Market consolidation encourage more rational dynamics

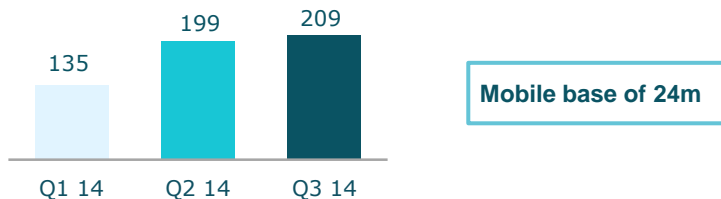
## Revenue stabilisation, the key lever for OIBDA improvement

- **OpEx growth (+3.2% y-o-y in Q3) to invest in quality growth**
  - ▶ Higher costs from TV contents and handset sales
  - ▶ Pension plan resumed (y-o-y not comparable)
- **Continued focus on cost control**
  - ▶ IT simplification, insourcing, distribution channel
  - ▶ Long term projects under analysis: copper switch-off
- **Margin +1.2 p.p. q-o-q on better revenue evolution**

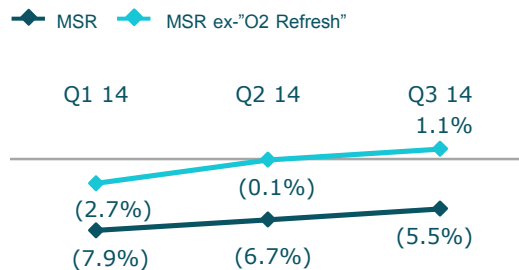
# UK: Outperforming the market & improving trends

14% of Group revenue

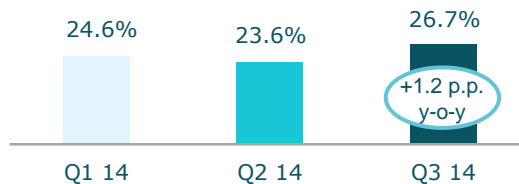
## Mobile contract net adds ('000)



## Mobile Service Revenues (y-o-y)



## OIBDA margin



Financial y-o-y change in local currency

## Solid commercial traction

- **Mobile base growth sustained at 3% y-o-y**
  - ▶ **Strong contract customer expansion (+6% y-o-y)**
    - New devices drive Q3 contract gross adds acceleration (+5% y-o-y)
    - Enhancing leadership contract loyalty in Q3 (1.0%; -0.1 p.p. y-o-y)
  - ▶ Continued LTE roll-out (49% outdoor coverage at Sep-14)
  - ▶ Q3 Prepay net adds (110k ; -8k in Q2) on **successful propositions** in May
- **Better ARPU trends ex-'O2 Refresh'** (Q3: -1.4% y-o-y; Q2: -2.6% y-o-y)
  - ▶ Price stabilisation
  - ▶ Data monetisation (LTE usage 2x non-LTE; high single digit ARPU uplift)

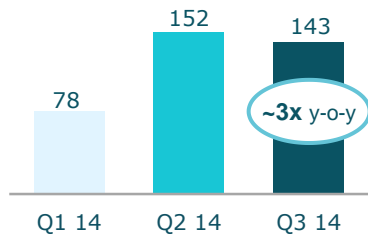
## Accelerating top-line growth ex-'O2 Refresh' in Q3

- **Revenue growth: Q3 +2.3% y-o-y ex-'O2 Refresh'**
  - ▶ **MSR trends keep improving**
  - ▶ 'O2 Refresh' deducted 6.6 p.p. y-o-y of MSR growth
- **Q3 OIBDA (€482m) expanded 2.7% y-o-y:**
  - ▶ Non-recurrent impact mostly related to final settlement from disposal of fixed business assets (€34m)
  - ▶ **Flat OpEx y-o-y on cost control** despite increased commercial activity
  - ▶ 'O2 Refresh' contribution gradually normalising from April-14
- Q3 OIBDA margin growth impacted by non-recurrent effects (+2.0 p.p.); 'O2 Refresh' impact in y-o-y change: Q3 :-4.0 p.p.; Q2: -1.0 p.p.

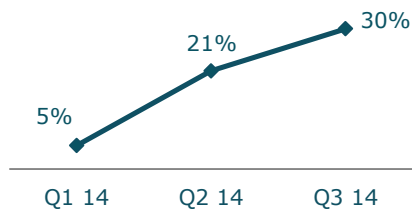
# Germany: Keeping momentum; E-Plus deal closed

9% of Group revenue

## Contract net adds ('000)

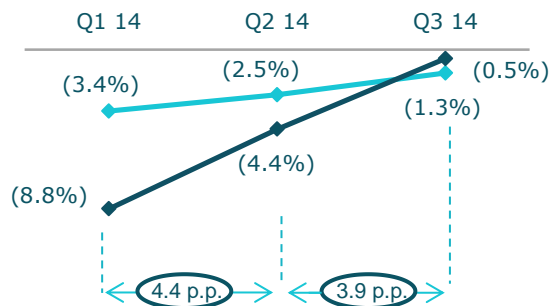


## Contract gross adds (y-o-y)

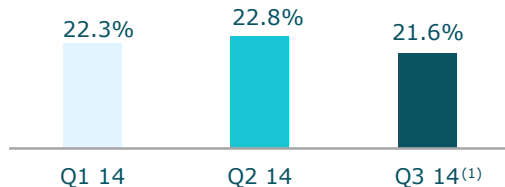


## Revenue (y-o-y)

◆ Revenues ◆ MSR ex-MTR



## OIBDA margin



(1) Excludes 8 million euros of restructuring costs related with the acquisition of E-Plus

## Commercial proposition driving value in a competitive market

### Data monetisation as key lever:

- ▶ Refreshed “O2 Blue All-in” portfolio improves mix: >80% gross adds in medium or higher bundles (Q3 13: ~75%)
- ▶ LTE gaining traction
  - 88% of Q3 total smartphone shipments (+33 p.p. y-o-y)
  - LTE usage (3x vs. non-LTE) drives mid double-digit ARPU upside
- ▶ LTE outdoor coverage at 59% in September

## Consistent MSR turnaround

### Improving revenue trend to stabilisation in Q3 (-0.5% y-o-y):

- ▶ MSR keep improving trend
  - Non-SMS/data sales at 74% in Q3 (+6 p.p. y-o-y)
- ▶ Robust handset sales (+22.1% in Q3 vs. -6.9% y-o-y in Q2) on:
  - Good acceptance of commercial proposition (device & tariff)
  - Launch of new high-end devices

## Commercial investments remain high

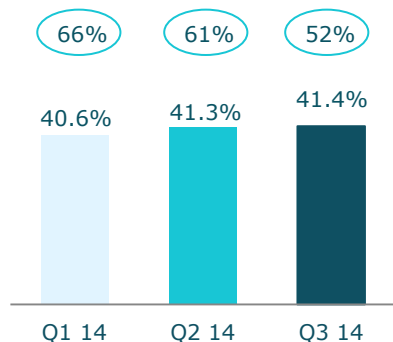
- ▶ Q3 OIBDA (€255m): -16.5% y-o-y (ex-restructuring)
  - ▶ Initial restructuring costs due to the integration with E-Plus (€8m)
  - ▶ Additional E-Plus transaction costs (Q3: €6m)
  - ▶ Higher commercial spend with the launch of new devices
- ▶ E-Plus to be consolidated from Q4

# Brazil: Strengthening position in value segments

22% of Group revenue

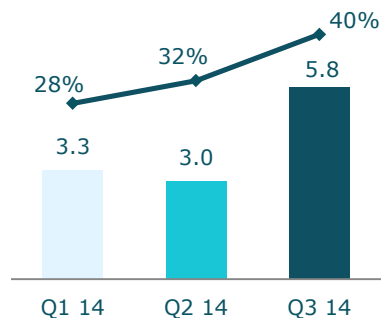
## Contract market share <sup>(1)</sup>

○ Net adds market share <sup>(1)</sup>



## Smartphone net adds (m)

◆ Smartphone penetration



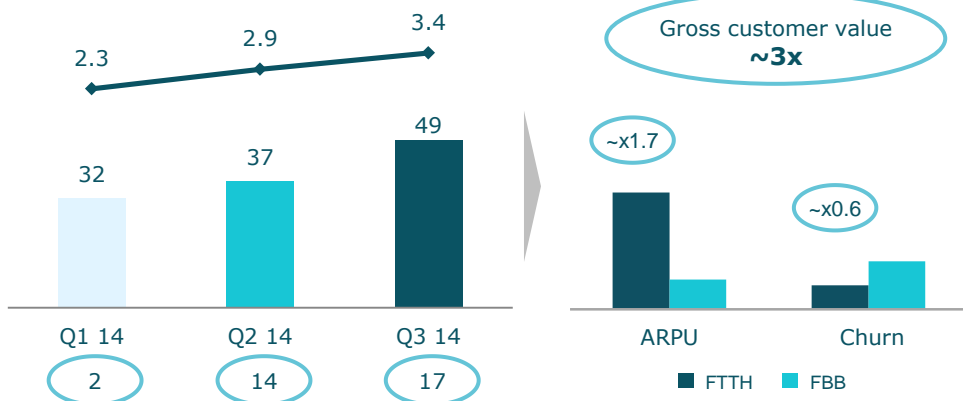
## Focus on mobile data

- **Strong contract & smartphones growth** (+23% & 2x y-o-y respectively) increasing customer base value:
  - ▶ Contract vs. Prepay: ARPU 4x; churn 1/3
  - ▶ Q3 Data ARPU +15% y-o-y (37% of total ARPU)
- **6th consecutive quarter capturing >1m contract net adds**; 10th quarter increasing contract market share
- **4G leadership**: 111 cities covered; 39% market share

## FTTH net adds ('000)

◆ Premises passed (m)

○ IPTV net adds



## Transformation process into a fiber Company

- **FTTH connections ramping-up** (322k accesses in Sep-14; almost 2x y-o-y)
- **Strong TV performance** (40k net adds in Q3 14, 88k in 9M 14) **underpinned by growing net adds on IPTV technology** (higher ARPU)

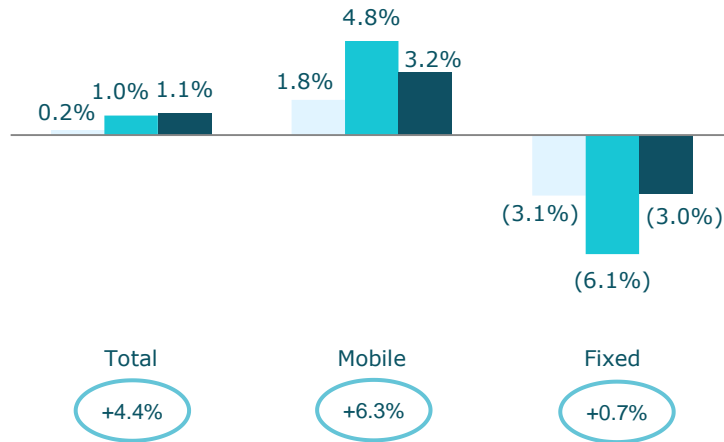
(1) Anatel public information as of August 2014

# Brazil: Growth acceleration in revenue and OIBDA

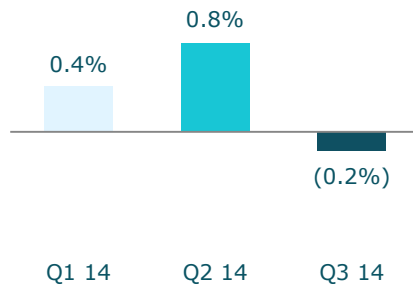
22% of Group revenue

## Revenue (organic y-o-y)

■ Q1 14 ■ Q2 14 ■ Q3 14  
○ Q3 14 ex- regulation

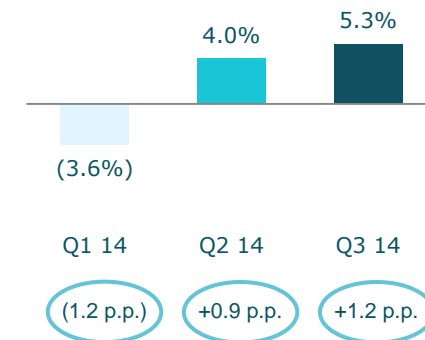


## OpEx (organic y-o-y)



## OIBDA (organic y-o-y)

○ OIBDA margin organic y-o-y



## Consistent revenue growth trends

- **Positive contribution from mobile & fixed businesses to revenue increase (ex-regulation)**
  - ▶ Non-SMS mobile data revenue performance (+37.8% y-o-y in Q3) boosting mobile service revenues
  - ▶ Fixed revenues (ex-regulation) growing again after 7 quarters, on better TV & FBB commercial traction
- **Negative regulatory effect**; dragging 3.3 p.p. in Q3 y-o-y organic revenue growth
- **68% of incremental MSR market share** captured in the last 12 months

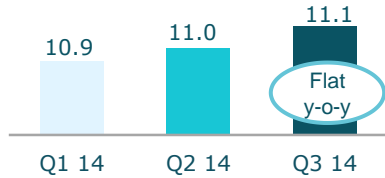
## OIBDA improvement with controlled cost evolution

- Steady revenue growth plus strict OpEx control driving **OIBDA y-o-y growth acceleration in Q3**
  - ▶ Lower supplies (on MTRs cut), personal expenses along with further efficiency efforts, offsetting higher subcontract expenses on higher commercial costs
- **Strong CapEx efforts** strengthening our market position (+25.5% y-o-y in 9M 14)

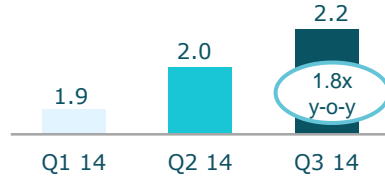
# Hispam: OIBDA +17.8% y-o-y, ex-Venezuela

29% of Group revenue

## Mobile gross adds (m)

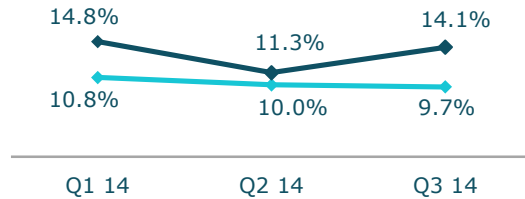


## Smartphone net adds (m)



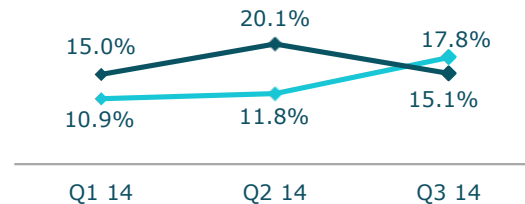
## Revenue (organic y-o-y)

◆ Hispam ◆ Hispam ex-Venezuela



## OIBDA (organic y-o-y)

◆ Hispam ◆ Hispam ex-Venezuela



	Q1 14	Q2 14	Q3 14
OIBDA margin (organic y-o-y)	+0.1 p.p.	+2.4 p.p.	+0.3 p.p.
Ex-Venezuela	Flat	+0.5 p.p.	+2.2 p.p.

## Strong revenue growth y-o-y

- **Non-SMS mobile data revenue (Q3: +47.9% y-o-y) accounting for ~50% of organic revenue growth**
  - ▶ Effective data monetisation: 26% smartphone penetration => 32% Data revenue/MSR
- **Mobile voice & FBB and new services steadily growing y-o-y (+9.9% and +15.5% in Q3 respectively)**
- **Higher regulatory effect** dragging organic y-o-y growth (-1.8 p.p. in Q3; -1.6 p.p. in 9M)

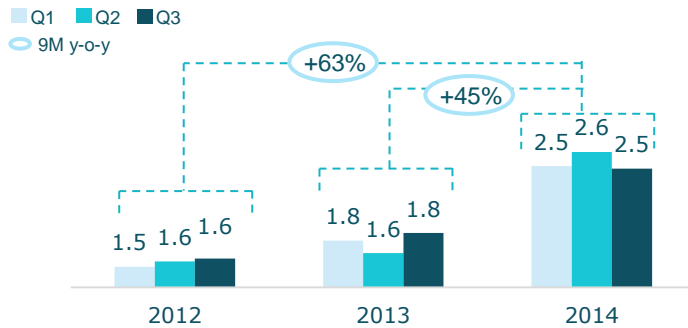
## Increased profitability amid strong commercial activity

- **Margin expansion across the board** particularly in non-inflationary countries
  - ▶ Q3 margin ramping-up y-o-y mainly in Mexico (+6.8 p.p.), Colombia (+5.6 p.p.) and Peru (+3.3 p.p.)
  - ▶ Similar commercial activity y-o-y with higher smartphones trading
  - ▶ Benefiting from efficiency measures and scale
- **All countries (excluding Uruguay & Chile) positively contributing to OIBDA y-o-y growth**
- **Strong CapEx efforts to secure future growth (+42.6% y-o-y 9M 14)**

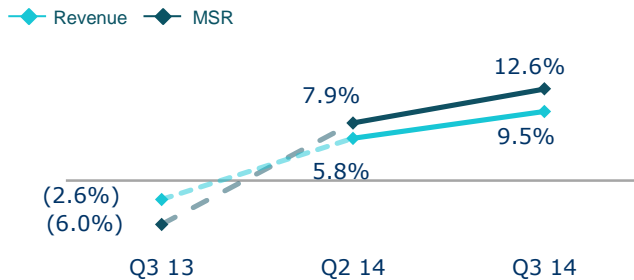
# Mexico: Quality assets & new regulation boosting growth

3% of Group revenue

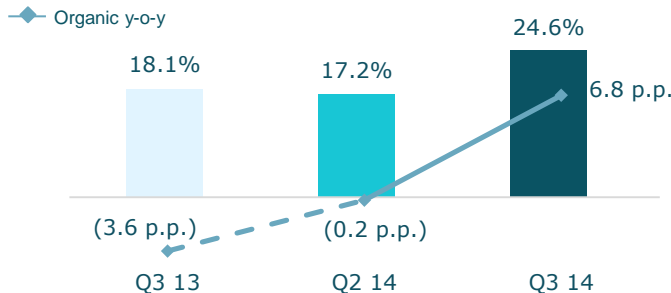
## Mobile gross adds



## Revenue (organic y-o-y)



## OIBDA margin



## Commercial turnaround already delivering results

- **Smartphone base doubling y-o-y**, but still limited penetration (24%; +11 p.p. y-o-y)
- **New LTE offer launched** in October to further reinforce our **commercial positioning**
  - ▶ Strong 4G network capabilities (10x faster speed than 3G)
- **New MVNO agreements already signed and in effect**

## Q3 OIBDA +50.6% y-o-y

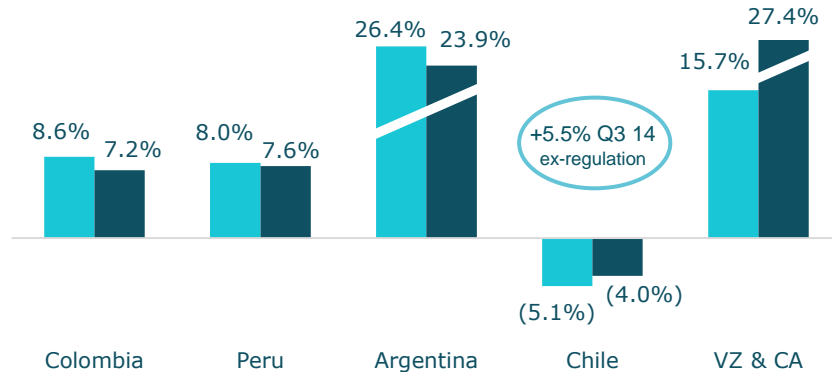
- **Steady revenue growth acceleration**
- **Highest MSR y-o-y growth in more than 4 years**
  - ▶ 2nd consecutive quarter of ARPU growth (+3% y-o-y) on voice & data traffic booming (+38% and 2x respectively y-o-y)
- **Strong OIBDA margin expansion y-o-y and q-o-q on:**
  - ▶ New regulatory framework in place from August 14<sup>th</sup>. Asymmetry of MTRs already effective
  - ▶ Commercial strength gradually flowing into economies of scale
  - ▶ The lowest margin in Hispam (-13.6 p.p. vs. 9M 14 T. Hispam margin)



# Rest of Hispam: Steady growth across the board

## Revenue (organic y-o-y)

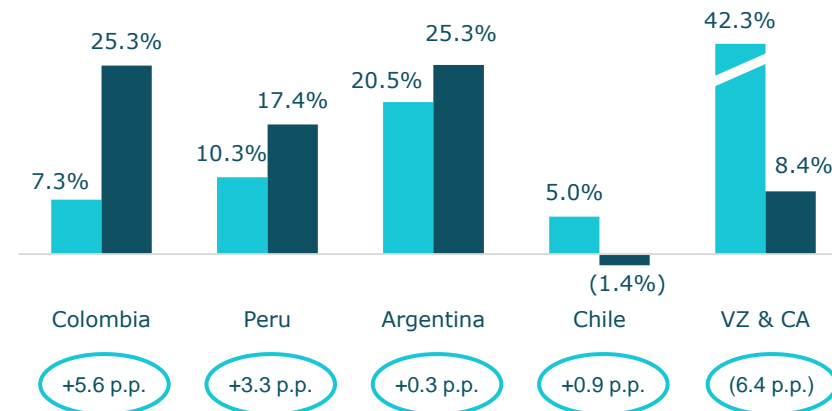
■ Q2 14 ■ Q3 14



## OIBDA (organic y-o-y)

■ Q2 14 ■ Q3 14

○ Q3 OIBDA margin (organic y-o-y)



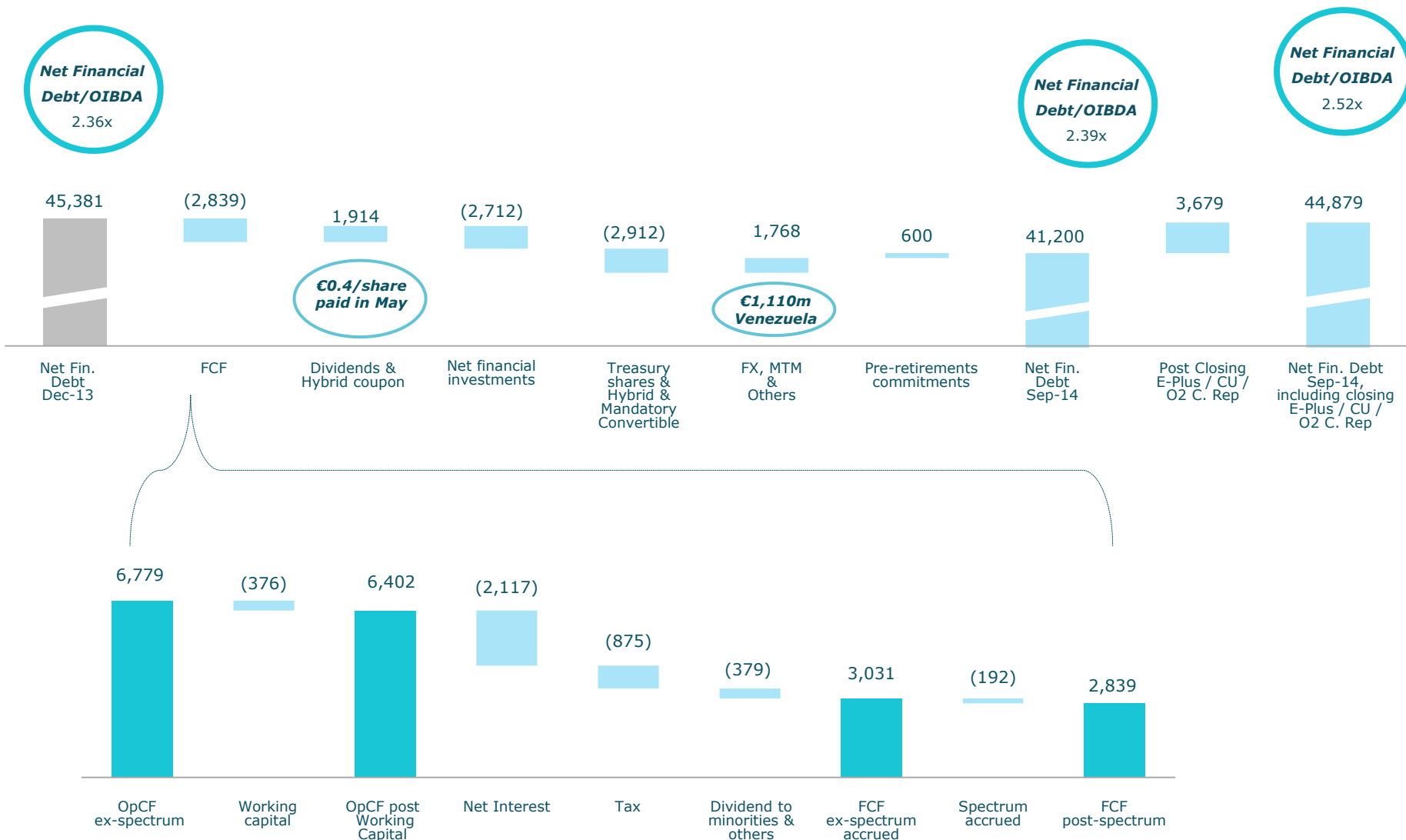
## Sound OIBDA growth y-o-y; acceleration in Colombia & Peru

- **Colombia:**
  - ▶ Increasing 4G adoption
  - ▶ Outstanding OIBDA margin expansion y-o-y on solid revenue growth and easier commercial comps
- **Peru:**
  - ▶ Solid commercial activity with record high prepay gross adds & record low churn in contract
  - ▶ Non-SMS mobile data sales booming (Q3: +45.5% y-o-y) and accounting for 2/3 of MSR growth
- **Argentina:**
  - ▶ LTE spectrum (AWS & 700MHz) secured in October to capture future growth opportunities
  - ▶ OIBDA margin (Q3: 25.3%) improving y-o-y despite inflationary pressure
- **Chile:**
  - ▶ Outstanding LTE rollout: 60% of population covered (Sep-14)
  - ▶ Q3 OIBDA margin (35.4%) expanding y-o-y even with higher gross adds (+11% total; +18% in contract)
- **Venezuela & Central America:**
  - ▶ Commercial activity recovered in Venezuela with the best net adds of the last 4Qs
  - ▶ Inflation dragging OIBDA y-o-y growth

# Net debt stable YTD despite E-plus payment & FX impact

## Net Financial Debt

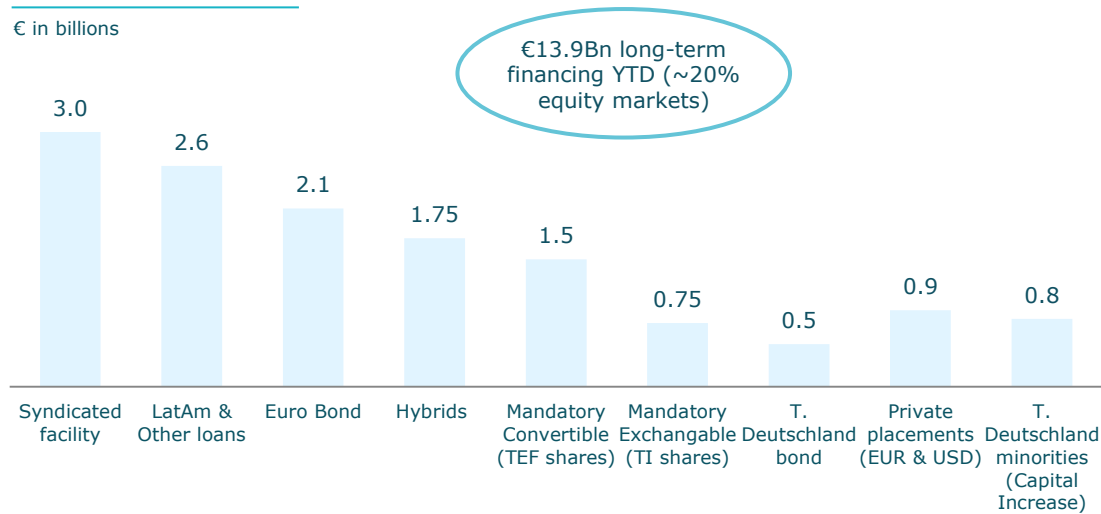
€ in millions



# Smooth maturity profile on long-term financing

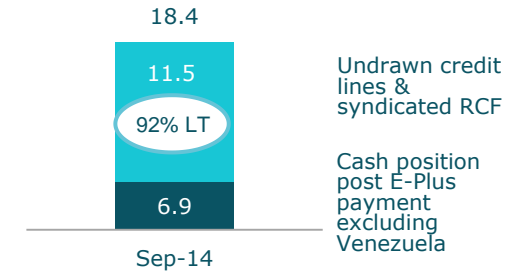
## Long-term financing

€ in billions



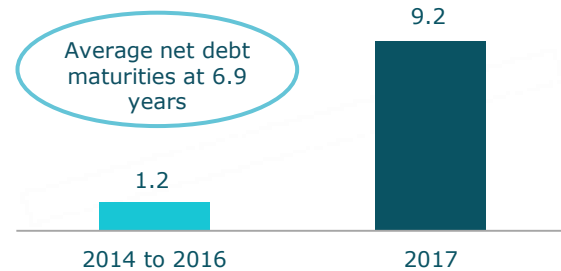
## Liquidity position (post E-Plus payment)

€ in billions



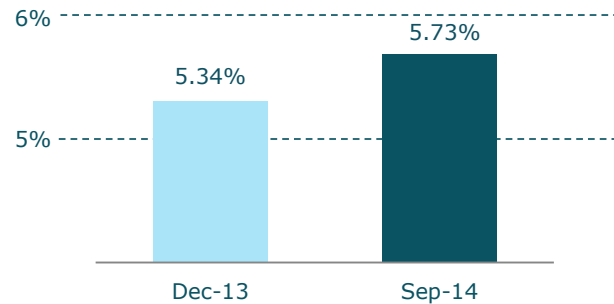
## Net debt maturities (Sep-14)

€ in billions



## Effective interest cost (12 month rolling)

--- Guidance



Cost increase due to:

- Higher liquidity cushion in anticipation of acquisition payments
- Larger weight of Latam currencies

# Summary

- **Successful strategy execution creates momentum into 2015**
- **Delivering high-value customer growth**
  - ▶ Record quarterly net adds in smartphones and fiber; increasing 4G adoption across markets
  - ▶ Effective management of customer loyalty
- **Revenues growing & accelerating in Q3**
  - ▶ Positive growth in the last 6 quarters, setting the basis for an attractive top line growth profile
  - ▶ Key drivers: T. Hispam (increasing at double-digit), T. España (smoothing decline) and mobile data (effectively monetising the data opportunity)
- **Stabilising OIBDA performance YTD; back to growth in Q3**
  - ▶ Sequential expansion of OIBDA margin (+0.4 p.p.); T. España (+1.2 p.p.); Peru (+5.3 p.p.); Colombia (+5.1 p.p.); Mexico (+7.4 p.p.)
- **Balance sheet strength**
  - ▶ Reducing net debt YTD even after German consolidation
- **Continued investments to ensure the best network / UBB / All IP while transforming our IT**
  - ▶ CapEx devoted to growth & transformation: 73% of total in 9M
- **Active consolidation in main markets**
  - ▶ Germany, Brazil, Spain



*Telefonica*

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