Telefónica

RESULTS

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Conference call transcript

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Introduction

Adrián Zunzunegui – *Global Director of Investor Relations*

Good morning, and welcome to Telefónica's conference call to discuss January-September 2022 results. I am Adrián Zunzunegui from Investor Relations.

Before proceeding, let me mention that the financial information contained in this document has been prepared under international financial reporting standards, as adopted by the European Union. This financial information is unaudited.

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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.

Ángel Vilá – *Chief Operating Officer*

Presentation

Q3 22 Results

1. **Steady execution of our strategy**

Thank you Adrián.

Good morning and welcome to Telefónica's third quarter results conference call. With me today are Laura Abasolo, Eduardo Navarro and Lutz Schüler. As usual, we will first walk you through the slides and will then be happy to take any questions.

We have again proven how to manage the current challenging macro situation. The relentless execution of our strategy has allowed us to report improving growth trends in euros in both revenues and OIBDA, and to reiterate our recently updated guidance and the dividend for 2022. Our streamlined and leaner operating model enabled us to generate a stable organic OIBDA margin vs Q3 21 despite ongoing cost headwinds. At the same time, we maintained a strong balance sheet, and have a strong liquidity position that covers maturities over the next three years.

Operationally we reinforced our leadership in our core markets. In Spain, MiMovistar helped to improve our commercial momentum and sequential OIBDA performance. In Brazil, our unrivalled operating and financial performance helped us to reinforce our leading market position; Germany posted strong operational and financial metrics while in the UK, VMO2 accelerated OIBDA growth as synergies started to kick-in.

And, whilst running our operations, we continue to build optionality. T. Infra vehicles have already passed 12m premises with fibre as of September, while the growth story of T. Tech continues to develop and remains a potential source of value. In T.Hispam we again reduced capital employed and crystallised value while Spain is set to benefit from the EU recovery funds and in-market consolidation. At the same time, we continue to expand our network leadership and to develop new opportunities for telco growth in the new Web 3.0 environment.

2. **Ongoing sustainable growth; strong balance sheet and FCF**

Moving to slide number 3, where we review how commercial growth flows down to FCF, within a prudent balance sheet management.

High-value accesses grew strongly once again this quarter, with fibre up +17% y-o-y, underpinning the UBB expansion to 166m premises passed, +6% up y-o-y. The transformation of our business continues at pace, and we now generate more than 70% of our service revenues from broadband and services beyond connectivity. We are very excited to see the remarkable +6.5% organic growth in B2B, proving right our T Tech approach.

At the same time organic OIBDA grew +3.1% on a group level, supported by sequential improvements in all of our core markets. On a reported basis, trends accelerated in the quarter, and we now report the second consecutive quarter of revenue growth and the first quarter of underlying OIBDA growth.

FCF improved as well throughout the year, growing +35% q-o-q.

From a balance sheet perspective, we are better positioned to face macro and market challenges thanks to our prudent debt management and solid liquidity position. Fixed rated debt represents 74% of total debt with an average debt life of 13 years. Furthermore, we have reduced leverage during the year even after M&A activity.

And finally, recent confirmation of a tax refund in Spain, for an amount of €1.3bn will be reflected during Q4 in our FCF, through lower tax and interest payments, and net debt reduction.

3. Financial update

Moving to slide number 4 for a quick review of our financial performance.

Reported revenue accelerated 10.5p.p. versus the second quarter to +11.2% y-o-y. Underlying OIBDA grew +8.5% y-o-y to €3.3bn, once impacts from changes in the consolidation perimeter annualised. Forex continued to contribute positively mainly due to the appreciation of Brazilian reais vs the euro.

FCF was strong in the quarter at €1.1bn, leading to €2.5bn in 9M or +68.2% y-o-y.

Net debt stood at €28.9bn as of September, roughly stable vs June, but if we account for post closing events, net debt would have been €26.7bn.

4. Effectively managing inflationary pressures

On slide 5 we give you an overview on how we successfully manage inflation. In Q3 reported annual growth rates in revenue, underlying OIBDA and FCF are above inflation for the average of countries where Telefonica operates.

Inflation can bring an opportunity for our revenue development as we exert pricing power in most markets which comes in addition to our strong B2B and wholesale position. However, inflation also poses a challenge to costs and that is why we continue to work on efficiencies, cost savings and simplification initiatives.

Energy costs for example represent 2% over revenue, but more than 60% of our 2023 consumption is hedged through long term PPAs, and we have an ambition to continue increasing the coverage. We continue as well working on initiatives to reduce energy consumption; fibre and 5G are 85% and 90% more efficient than copper in terms of energy consumption, and deployment brings forward legacy shutdowns. Such as the copper decommissioning project in Spain, which we aim to complete in 2024.

As for labour costs, they account for around 13% of group revenue, below our peers and showing the steps taken to manage this opex item.

Our CapEx peak is behind us, with an outlook for the year of up to 15% of sales, whilst active tax management at Group level provides an additional buffer, supporting FCF.

5. **2022 guidance and dividend confirmed**

Moving to slide 6, let me confirm our full year guidance and dividend. We believe these results demonstrate our ability to cope with an overall tougher context than originally anticipated.

Nine months results are aligned with our full year target for revenue of “high-end of low single digit growth” and OIBDA of “mid-to-high-end of low single digit growth”, while CapEx to Sales at 13.8% stands well within the “up to 15%” target.

On shareholder remuneration, and as previously stated, we will be paying the first tranche of the 2022 dividend of 0.15€/share in cash in December 2022 and the second tranche of 0.15€/share in June 2023.

In addition, we will propose to the AGM the adoption of the corresponding corporate resolutions for the cancelation of 0.4% of shares held as treasury stock as of 30th June 2022.

6. **Progressing on ESG agenda**

Moving to slide 7, we report on our progress across the pillars of ESG.

On the environmental side, we continued to implement our renewable energy plan, thereby reducing emissions. Chile has become our 6th market to become 100% renewable, joining Brazil, Germany, Peru, Spain and the UK, with the rest of Hispam ramping up to 50% renewables by the end of the year. With this progress we are fully committed to reaching our target of 100% renewables across the Group by 2030. In parallel, we were the first telco to publish a detailed Life Cycle Assessment report, which demonstrates our alignment with the EU Taxonomy.

Within the social dimension, we continued to bridge the digital divide, connecting more people and more places. Through our Infra unit, we expanded our FibreCo portfolio with deals in Spain and the UK, bringing digitalisation to the underserved. We also progressed on diversity and inclusion. Our comprehensive equality policy was approved by the Board, establishing minimum groupwide standards to ensure we achieve our gender equality objectives such as pay gap and equal representation.

In Governance, we remain committed to the highest standard of business ethics. As of the end of September, 74% of employees had taken our responsible business principles course in the three months since its launch.

7. **Spain**

And now, let me start with the review of our businesses on slide 8.

Telefonica Spain’s commercial activity continued to improve in Q3 22 across all KPIs. In a more rational market, FBB and mobile contract grew sequentially.

The convergent "miMovistar“ portfolio gained traction, and now exceeds 1m customers. ARPU grew y-o-y for the third consecutive quarter and churn improved again to 1.2%.

In a complex environment, our better levels of ARPU, churn, and NPS, confirm our premium market position. The better-quality experience perceived by our customers, that enjoy a compelling and complete portfolio with unmatched value is the main driver behind this success.

Revenue grew y-o-y for the 6th straight quarter, although growth decelerated due to a tougher y-o-y comparison for handset revenue, and lower wholesale TV revenue, as the new football model kicked in. Excluding this latter impact, service revenue trends showed another sequential improvement.

OIBDA y-o-y improved by 0.6 p.p. sequentially to -2.8% y-o-y in Q3 22 on a lower energy drag, content cost deflation and ongoing efficiencies from the redundancy program and network transformation.

8. Germany

Moving to Germany on slide 9, which has delivered another quarter of strong operational and financial trends.

The Company's mobile base continued to expand due to core business momentum and strong traction of the O_2 Grow tariff.

Revenue grew by +6.0% y-o-y in the third quarter driven by sustained mobile revenue momentum of +6.6% y-o-y and a record third quarter for handset sales which grew by +18.9% y-o-y.

OIBDA grew +4.2% y-o-y with continued own brand momentum driving improved operational leverage mainly in mobile, and further efficiency gains as well as some roaming support.

In line with plans in its final year, Telefonica Deutschland continued to execute its 'investment for growth' programme, with Q3 representing peak investment in 2022, so that 5G coverage now stands at 75%.

9. Virgin Media O2

We now move on to slide 10 and our Joint Venture in the UK, Virgin Media O2, which has made strong strategic and operational progress supporting delivery of synergies.

Customer growth trends improved in fixed, mobile and converged products, as the Company passed a significant milestone as it connected its 1 millionth Volt customer in September, highlighting its continued progress in convergence.

Network investment has continued, so that the fixed network now reaches 16m premises and is on-track to deliver over half a million new network premises in 2022, with 5G connectivity now available in over 800 towns and cities.

In the third quarter OIBDA growth accelerated to +8.1% y-o-y, which includes a 3.3p.p. impact of a non-cash non-recurrent effect and was also supported by the delivery of synergies and continued cost efficiencies.

10. Brazil

Moving to Brazil on slide 11, Vivo released an outstanding set of results, growing double digit in both accesses and main financial KPIs.

Contract accesses grew +18% y-o-y after capturing more than 70% of new connections in the market during July and August.

FTTH connections accelerated in Q3 and were up +9% vs. June thanks to the progressive fibre deployment which has already reached 22m premises passed., an increase of almost 4m in just 12 months.

Despite inflationary pressure, which has started to ease in the country, y-o-y organic OIBDA growth accelerated to +12.3% expanding the margin to a remarkable 43%.

OIBDA-CapEx increased by +4.4% in first nine months of the year, despite the acceleration of our own fibre deployment.

And finally, Vivo continues to put ESG at the core, being in the top 100 companies in the Refinitiv D&I Index 2022.

11. Tech, consistent delivery, sustainable and resilient growth engine

Moving to the next slide.

Telefónica Tech consolidated its position as a leading Tech solutions provider, with solid y-o-y revenue growth of c.+70% in Q3 22 and 9M 22 (c.+30% y-o-y growth in constant perimeter). Both businesses grew more than +70% in in 9M 22.

Main drivers of this consistent market outperformance are T. Tech's profile and its differentiated go-to-market approach:

- Around 5.8k professionals, mostly located in Europe, with high value skills in Professional and Managed services, strong credentials, higher geographic diversity, and, in the last twelve months, €1.4bn of revenue.
- A differential customer journey based on the migration from traditional Communications & IT services to Next-Gen IT solutions. This allows Telefónica Tech to be the trusted partner to accompany the large base of B2B Telefonica customers in their path to full business digitisation and optimisation.

Commercial activity remains robust in both Cyber & Cloud and IoT & Big Data, with bookings growing by 60% y-o-y, which will support a sustainable revenue flow going forward.

Finally, in Q3 we strengthened our partner ecosystem, with Aruba, McAfee and Sateliot among others, and reinforced Cloud capabilities. For example, we achieved Specialization distinction from AWS and Netskope for our technical expertise and exceptional scale of services.

12. T. Infra, unique portfolio of best-in-class assets

Turning to slide 13, we offer a unique portfolio of best-in-class FibreCos both in Europe and in Latam with an aggregated target of >25m premises to be passed by 2026, from the current 12m deployed to September 22.

In July we announced the creation of Bluevia in Spain, and also the fibre the JV in the UK with Infravia Capital Partners and Liberty Global.

In Germany, UGG signed MoUs to deploy 550k premises and one additional wholesale agreement with a regional ISP.

FiBrasil, enhanced its commercial position, announcing wholesale agreements with Sky Brasil and Vero.

OnNet Fibra Chile reached its deployment target of 3.5m premises passed by 2022 ahead of plan and strengthened its market leadership by announcing the purchase of Entel's fibre network. With this transaction, Entel will become a wholesale tenant.

In Colombia, OnNet Fibra, is not only the largest neutral wholesale FTTH provider in the country, but also the market leader.

On another front, during the first nine months of the year, Telxius subsea cable maintained its strong commercial momentum which together with good cost management fuelled y-o-y OIBDA growth of +13.6% organically and +26.3% on a reported basis. Bandwidth provisioned for capacity services grew by +46% y-o-y in the first nine months of the year and the value of contracts signed with third parties increased by +17% y-o-y during the same period, as result of the incremental demand from hyperscalers and relevant carriers.

I now give the floor to Laura, who will review Hispam's operations and the Group's financial results.

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

Hispam

Thank you, Ángel.

Moving to next slide.

On Hispam, the quality of accesses continues to improve thanks to the strong momentum in contract and broadband. FTTH connections now account for 81% of total FBB accesses, up 10 p.p. y-o-y, due to the successful execution of the alternative fibre deployment model. This deployment allows us to capture the growing demand for fibre and at the same time to reduce exposure to the region.

Revenue and OIBDA continue to grow y-o-y organically, +3.8% and +1.2% respectively thanks to accesses' growth and the progressive generation of synergies. Operational efficiencies offset inflation and commercial costs pressure.

OIBDA-CapEx grew a remarkable +15.1% y-o-y in the first nine months of the year.

Finally, Telefónica is acknowledged as the Telco with the best corporate reputation in Latam by Merco.

Prudent management, contained cost and sound liquidity

Turning to slide 15, following the intense long term financing activity over the last years, we face a smooth maturity profile.

We maintain a solid liquidity position of €22.1bn that compares with a 2023-2026 gross debt maturities average of €2.9bn, -56% lower than the four-year average we had at September 2016. This light maturity profile, together with the strong liquidity position, especially after cashing in some inorganic deals, allows us to cover debt maturities over the next three years.

As of September, we have a contained interest payment cost, amounting to 3.94% vs 3.86% in December. Our debt is 74% linked to fixed rates, mainly in euros, which is a solid position to face rising interest rates in the coming years.

Net financial debt stands at €28.9bn as of September. Considering post-closing events, it will decline to €26.7bn deleveraging to 2.52x end of period net debt to OIBDAal, despite M&A activity in 2022. We also strengthened our balance sheet, with shareholder's equity increasing 15.8% vs December 2021 to €25.7bn at the end of September.

I will now hand back to Ángel who will wrap up.

Ángel Vilá – *Chief Operating Officer*

Ongoing sustainable growth

Thank you Laura.

To wrap up, on slide 16.

Sustainable growth continued in Q3, with improving momentum in reported terms while successfully managing macro challenges. Commercial actions based on our network leadership are supporting growth and our customer journey.

I would like to highlight again the strength of our balance sheet, our liquidity position and FCF capabilities which are key in these uncertain times. FCF and net debt will reflect in Q4 the tax refund in Spain on which we received confirmation of last week.

I also want to reconfirm our guidance and dividend for 2022.

On an industry level we continue to play an active role to encourage the development of open standardised APIs to position us and the industry for new growth opportunities in the digital word.

And finally, let’s not forget we are helping society thrive, promoting economic and social progress based on digitalisation.

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

Q&A Session

Yemi Falana – *Goldman Sachs*

Two questions from me on Spain. I think one of the key highlights in this quarter was just some strong cost control and some relatively robust EBITDA margins in that business. So, could you provide some colour around the ongoing lower OpEx that you expect as copper decommissioning continues and as you flagged is completed in 2024? How much of a tailwind do you think that can be for margins into next year?

And then secondly, just on the NPS and churn development, appreciate churn has been low for some time and NPS has been high for some time. So the changes quarter-on-quarter are relatively small, but could you maybe talk to some of the moving parts that have seen churn tick up slightly and NPS ticked down slightly in the quarter.

Ángel Vilá – *Chief Operating Officer*

Thank you very much for your questions. On the first question regarding cost control, OpEx and margin, we are clearly making a very strong effort in efficiency in these times of uncertainty and high inflation. We have managed, as you can see on the slide, to slightly increase the OIBDA margin in this quarter in Spain versus the previous quarter.

And this is the result of several moving pieces.

- On one side, personnel costs are down year-on-year, thanks to the redundancy program that we launched earlier in the year and the moderated salary increase that was applied in 2022.
- On supply costs, we are already experiencing benefits from the lower content cost related to the renewal of La Liga that already came into effect this quarter.
- On commercial costs, we are seeing different moving parts. Some of our revenues come with higher equipment costs, but at the same time, we are optimising the cost of our commercial activities.
- In operating expenses, we have the increase of energy prices that in the third quarter has been lower than what we saw in the previous two quarters.

We are working intensely to manage, in particular, this energy cost, and we have moved swiftly to have the energy line 80% hedged in Spain at prices that were agreed before the big rise in costs. So, we have been negotiating PPAs that are gradually coming into effect. And these PPAs are at prices around €60 per megawatt/hour, which are much lower than what we have seen this year, which means that if spot prices were to stay where they are, combined with the hedges that we have now for 80% of our consumption, the energy line for the Spanish operation would experience a slight decline in 2023.

All in all, we continue to see that we can deliver margins in the high 30s, and potentially in the fourth quarter at the level of what we saw in Q3 or potentially a bit higher.

With respect to the second question on NPS and churn, we believe that it's the result of the positioning that we have in our Spanish operation, we have developed a strategy of giving our customers the best connectivity with the best entertainment products, also with additional digital services beyond connectivity, such as home security, alarms, and now we are getting also into home solar generation, together with the best financing coupled with these services. And this is resulting in a consistent performance in NPS, which had reached the highest value that we have ever had, and also with another sequential decline in churn because these type of services provide the stickiness to our customer base.

Yemi Falana – *Goldman Sachs*

Could I just clarify, it's 80% hedged for 2023? At €60 per megawatt hour or is that for this year?

Ángel Vilá – *Chief Operating Officer*

No, I was talking about 2023. We are 80% hedged, price per megawatt hour is €60.5 MW/Hour.

Pilar Vico– *Credit Suisse*

So, the first one is around Mi Movistar. I'm not sure if you could please provide a bit more colour on the performance, the speed of the migration from Fusion and also how you're seeing O2 performing?

And the second one is probably more related to the higher rate environment that we are seeing. Has this changed the approach you have to your capital allocation strategy?

Ángel Vilá – *Chief Operating Officer*

Thank you, Pilar.

Regarding Mi Movistar, it's fulfilling the expectations that we had on churn reduction and on upselling, it's still in progress in the market, but already subscribers, only 5 months after launch, are already surpassing 20% of the convergent base in September.

- The gross adds that we are getting with Mi Movistar are delivering higher ARPU if you compare Q3 22 to Q3 21.
- We are seeing a large preference for mobile services, 2.5 lines per pack, and unlimited data packages.
- There is an excellent reception of TV add-ons with football penetration in line with expectations, and this has helped us capture a higher percentage of football customers that had left the content at the end of the previous season.
- We are getting a reduction of churn in convergence, -0.2p.p., thanks to Mi Movistar, and we are seeing 6p.p. higher NPS versus Fusion and larger handset redemption. So far, this is performing quite nicely.

With respect to O2, subscribers continue to grow on the back of the new portfolio that is enhancing the positioning in the market. So, we are having quite a positive evolution in gross FBB additions and in churn, which is making us more competitive in the low-end segment.

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

With regards to higher rate environment, thinking of the debt refinancing, we maintain a very conservative approach to it. And the financing activity has been very intense in recent years, as you have followed, and we have taken advantage of historical low refinancing rates to extend average debt life and smooth our maturity profile in coming years. The very high percentage of debt we have on fixed rates allow us to be much more resilient in this current environment.

If we touch upon the capital allocation question as well, in the past year, we have been allocating capital very strictly. We have been focusing on the core OBs, and in growth and growth comes from having a stronger OBs and also from the tech business unit that is growing nicely.

There's no doubt, the cost of capital is rising. And therefore, we will be even more strict in this capital allocation, and we will also give higher priority to our strong commitment to investment grade, which is here more important.

But as an overall context, we have done the homework to tap the market at the appropriate time and to be more resilient in this environment. And I remind you the very high liquidity figure we have and how we cover maturities over the next 3 years.

David Wright – *BofA*

A couple of questions for Laura, please. Firstly, on the hybrid refinancing that is coming due. They look to be very expensive right now. So, I'm just wondering how you're approaching that given you obviously carry an equity credit, but I'm sure you wouldn't want to lose from the balance sheet.

And question number two, we have talked about Hispam for some time. You guys moved it to effectively a non-core region. I'm just wondering if there's been any change in thinking about Hispam? Is there still a for sale sign out there on these assets? Or is it something that you guys are quite happy to maintain in the group now that there's some good commercial performance.

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

Thank you, David, for your questions.

Regarding hybrids; hybrids is definitely a part of our capital structure and it has served its purpose and for rating agencies it has, as you know, the 50% debt component and also the 50% equity component. Obviously, then it's more expensive than plain debt. But at the same time, the equity component has also been very attractive in the past years and up to the large refinancing we did. In fact, as you know, the cost of the layer is 3.56%, and it has been reduced very much in the last years. And due to that prudent refinancing, even with higher costs, we still are benefiting from that refinancing exercise we've been doing in recent years, so we shouldn't have a big impact in the medium term.

The company is committed to this layer of hybrids. Our intention is to refinance and exercise the calls in a manner that is consistent with best market practice. We have been prudent in managing that hybrid profile and we will continue to approach them in that way.

There's no doubt that you said, costs are becoming less attractive. But as I also said that prudent refinancing allows us to keep on benefiting from those lower costs in the medium term.

We are not in a hurry, we have time to decide as we have until June 23 to exercise our next hybrid call, part of which was already refinanced in the past. And we can also eventually make use of the permitted flexibility from S&P, which allow us, and define as immaterial, repurchases up to 10% of total hybrids outstanding over 12 months and 25% over any 10-year period.

So, we will keep adapting and navigating through the different market conditions. But as I said, the prudent financing we did in the last years, and that low blended cost that we have for the layer allow us to be somehow more protected in the medium term.

Your second question on Hispam, our strategy has not changed. I mean, Hispam is non-core, but it does not mean Hispam is for sale. What you should be expecting is for us to continue managing Hispam as we have been doing. We are building strong pillars, we are growing value accesses, in contract and fibre. We are delivering a lot of efficiencies from the operating model, from much less capital-intensive investment models. We have improved the capital structure. Hispam is giving us optionality, either because of the better organic improvement, or as it has more value today for other inorganic options.

So, we will keep on working as non-core, a low capital exposure and creating value for whatever option we decide to pursue.

Luigi Minerva - *HSBC*

The first one on your thoughts about introducing inflation indexation in Spain as you point out in the slides, you have it in other countries, and you can exercise pricing power consequently. And I think if I'm not wrong, Vodafone Spain signalled that they would be keen to introduce inflation indexation from 2023. So what are your thoughts about Telefonica Espana doing something similar?

And the second point is perhaps a comment on consolidation. Now we had the opinion from the ECJ Advocate General on the U.K. case, which was not supportive. I mean what are your considerations about it and whether you see any consequences for the Spanish consolidation, for example?

Ángel Vilá – *Chief Operating Officer*

Regarding the first one on inflation indexation or pricing reviews in Spain.

We believe first that the market is consolidating its rationality. We have seen several proof points in the third quarter in the back-to-school campaign, as promotional activity has been more muted than in previous years. Vodafone introduced the retail price increases based on inflation that will be effective from Q1 '23. We have seen more-for-more moves. We did such a move in February '22. Then Euskaltel did it in June, Orange in July in B2C, Orange also did some in October for SMEs. We have seen that even small players like Avatel are including new clauses in the contracts, paving the way for raising new tariffs.

In Telefonica Spain, we have implemented repositions of tariffs every year since 2015 or so, always under commercial criteria, mostly with price hikes above inflation. Only the latest movements were below inflation given the circumstances. And we do plan to continue implementing this strategy, we definitely have more-for-more on our near-term agenda.

Regarding consolidation, we believe that Europe needs a more flexible approach regarding intra market consolidation because it's a very fragmented market. And any intra market consolidation could bring bigger investment capacity, greater certainty in new generation investments and so on. We have seen, of course, as everybody, the ruling of the Court of Justice and the conclusion of the Advocate General which we believe does not prejudge the final judgment of the European Court of Justice because there are many factors to be taken into account for this type of consolidations.

And in particular in the Spanish case, we believe that the JV modifies the wholesale and retail communications and TV markets. So, the regulator must analyse the transaction, and potentially propose remedies. But the approach should consider the landscape of the sector, which is a very highly fragmented market, a very competitive fibre wholesale environment, with ARPUs struggling for most of our competitors, return on capital employed below WACC for all the players except Telefonica, and the need to step up 5G deployment.

In addition, this consolidation will mean that Telefonica, in terms of number of customers, will be not dominant in some areas which should lead to certain deregulation that we are under now.

Also, football costs of the merged Orange-Masmovil would be higher because the regulated formula takes into consideration the number of customers and number of TV customers. And this JV does not imply a relevant infrastructure concentration.

So, we think that all these factors should be taken into account in order to proceed with this transaction.

We are supportive, provided that relevant or the required remedies are implemented. And we believe that it's consistent with both what we have seen in the European Court of Justice ruling and the comments that the Advocate General has made.

Mathieu Robilliard – *Barclays*

First, I had a question on energy costs. I wanted to expand a bit at the group level. You just pointed out that Spain energy costs could be down year-on-year because you started hedging before most of your competitors. In Germany, we learned yesterday that thanks to the German government, energy cost could be flattish. I think you have also good levels of hedging in Latin America.

So the question is, is it conceivable to believe that in 2023 at the group level, the headwind from higher energy prices will materialise in a much smaller increase in energy cost or no increase at all. And if you could quantify what it was for 2022, that would be sort of helpful.

And then the second question was on labour costs. You did flag that you had signed agreements in Spain for contained wage inflation, and I was wondering if that was still the prospect of 2023 in Spain?

Ángel Vilá – *Chief Operating Officer*

Thank you, Mathieu. I'll take both questions. And I will go with a little bit of granularity because the situation is different in different countries.

Starting with energy. As I was saying before, in Spain, going into 2023, we are 80% hedged at attractive prices that were set up in PPAs that were signed before all this crisis started, but have not been coming into place until now and gradually building up. So, if spot prices were to stay where they are, given the level of hedge, the overall bill in Spain would be declining.

In Germany, with the government decision that was announced 2 days ago to cap the energy cost at €130 per megawatt/hour for companies for 70% of the consumption of the prior year, as my German colleagues were saying, that gives us confidence that we will keep the energy cost broadly stable in 2023. This €130 per megawatt hour price is a 20% discount compared to the average energy cost we had in 2022 in Germany.

In the U.K., we already have hedges for more than 80% of the consumption for 2023, albeit the prices imply an increase in the energy cost.

In Brazil we have hedged 79% through long-term agreements and the rest is regulated at prices between $40 and $50 per megawatt/hour.

And in Hispam, the situation is even more stable with prices, which are lower in regulated markets.

So, all in all, we think that the increase that we have seen in energy costs for the group in 2022 is not to be repeated in 2023, which is a situation much more managed and already hedged, although with the differences that I gave to you in the different markets.

Mathieu Robilliard – *Barclays*

Could you quantify what you think the 2022 impact will be at this stage?

Ángel Vilá – *Chief Operating Officer*

Please follow up with IR because I don't have such a granular detail with me.

Moving on to labour costs, also going country by country.

In Spain, we had 1% wage increase in 2022. We have a collective agreement with the unions where there is a commitment to maintain purchasing power in the accumulated period of 3 years of '19 to '22, and wages in the initial part of this period rose above inflation. So, there will be a compensation in 2023. But it's still early days as we have not started the negotiations, but there will be an increase in labour costs higher than what we have seen in 2022.

In Germany, the increase was 3.4% for all employees, plus some particular help to some segments of the employees, and the negotiation is still pending for 2023 and our German colleagues expect a reasonable outcome.

In the U.K., in 2022 there was a 3% pay rise with also some special aid for some specific employee segments. And it's too early to tell for 2023. There are good relations with unions and employee representatives, but the conversations still have not started.

In Brazil and Hispam personnel costs increased with inflation going into 2023, we're aiming to be at inflation or slightly below.

As a principle, we will aim to negotiate below inflation prices that would be our principle. But these conversations are still pending.

And the second principle, which is very important is that we will continue to work to offset the incremental personnel costs at least partially with other efficiencies. And in the case, for instance, of Spain, the content cost deflation and the stabilisation-to-reduction in the cost of energy plus other efficiencies will go in this direction.

But we still have pending the negotiations with the employee representatives. And as soon as there is more precision on this, we will update the market.

Keval Khiroya – *Deutsche Bank*

Two questions, please. So firstly, going back to the question on LatAm, you've been very clear on the strategy, but has there been any increase in the prospects of consolidation in these markets as a cost of funding for some of the players may be higher and the returns are still low?

And then secondly, a longer-term question, but you are a long-term investor in TEF D. Once the 1&1 network won't affect the TEFD wholesale cash flows of the medium term, it could be more mature long term. How concerned are you about this future free cash flow loss? And would you entertain any other strategic possibilities other than allowing for another network to be rolled out given you are in favour of network consolidation rather than duplication.

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

Not sure about the first question. I think you were talking about cost of funding, but you were talking in general or related to Hispam?

Keval Khiroya – *Deutsche Bank*

Sorry, some of your peers in LatAm, some of the smaller players have a higher cost of funding and the returns are still low. Do you therefore see any increase in the prospects of consolidation in Hispam?

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

It could be the case. I think in general, we have to be much more stricter in the use of capital, not only for M&A investments, also for CapEx as we've been doing in the region. And I think in Hispam, we've been very disruptive in the model to reduce cost of capital, whilst we are achieving very sound and very good results commercially. So, we are doing in a very sustainable way.

When we look at the results of the competitors, not everyone is doing well, and I do see there's much more appetite to reduce capital as a sector. So, there are more conversations on sharing than there has been in the past. You know we've been very, very proactive. The FibreCos we have done is a way of sharing, and now Entel is going to be part of On-net, which is very good news. And for 5G, we definitely have to go down that route.

As for in-market consolidation, you know the countries where there could be more benefits. I'm not saying that we are working on anything, it's just public information on potential synergies there could be. In Colombia, they are probably too many players. We've just gone through the merger of VTR and Claro in Chile that has been approved. So, there are opportunities.

And I could say that in the same way the focus from Telefonica on Hispam has been different, and that's even more necessary today with the increased cost of capital, I think the rest of the Hispam sector is going in that direction.

So, there could be some movements.

Ángel Vilá – *Chief Operating Officer*

And regarding Telefonica Deutschland, we are very pleased with the performance of the company. Germany is clearly one of our core markets and continues to deliver value for shareholders. Telefonica Deutschland continues to grow revenues and EBITDA at pace. And we have also passed the peak of the "investment for growth" program, which bodes well for operating cash flow performance going forward.

With respect to other networks, we have a lot of respect for 1&1 and their initiative. It's a project in which the market still has only limited knowledge about the details of the rollout, and we keep on getting updates from time to time from them. With the national roaming agreement, and with the agreements that we have with 1&1, we expect to have a broadly stable gross margin profile in the mid to long-term, which provides good visibility on Telefonica Deutschland´s gross margin, EBITDA and cash flow evolution.

So, we have lots of respect for them. It's difficult to say how the market will evolve. And for the time being, with the contracts that we have in place with them, and what we foresee on 1&1´s network development, gives us comfort on predictability of the P&L of our operation in Germany going forward.

Thank you very much. We hope we have been able to respond to your questions. Should you still have further questions we kindly ask you to contact our Investor Relations department.