TELEFÓNICA

COMPANY REPORT

TELECOMMUNICATIONS SERVICES

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STUDENT: FRANCISCO M. LOURENÇO

francisco.m.lourenco2013@novasbe.pt

Troubles At Home

Sceptical view Spain offsets positive stance over Brazil

Bearish outlook for Spain (48.1% EV)

Despite the focus on LTE (c.59.0% coverage) and FTTH deployment (11.5 homes passed) and a strong push for pay TV and smartphone subsidization, we consider that TEF's commercial portfolio is inferior to its peers, both in terms of price and bundle size. Hence, we are expecting further 3.8 and 8.2pp MS erosion on mobile and broadband market shares, respectively.

Strong Brazil with GVT integration (BRL41.9/sh, BUY)

We consider that the Eur7.2bn takeover of GVT allows Vivo to compete more directly with AMX and Oi in 4P products at a country level, while consolidating its front seat position in SP. At the same time, we expect a positive pressure on residential ARPU due to GVT's superior network.

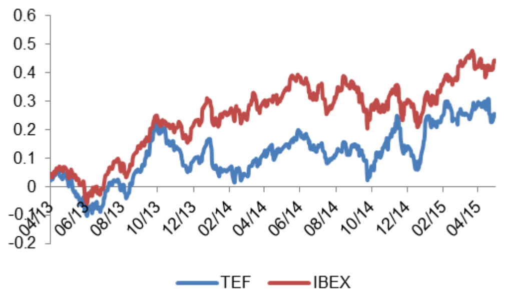
Concerns over LT strategy in Germany (Eur4.5/sh, SELL)

In Germany, the Eur8.6bn acquisition of E-Plus makes O_2 the largest mobile operator with a subscriber MS of 37.4% in FY14, with expected improvements on its much-debated connectivity issues. However, we consider that O_2's low relevance on FBB (8.1% MS FY14) leaves TEF in a weak competitive position in the midst of increasingly convergent telecoms markets in Europe. Telekom (41.3% FFB MS, 34.6% mobile MS) and Vodafone (17.9% FBB MS, 28.0% mobile MS), already offer fixed-to-mobile tariffs and whereas TEF hasn't shown any intentions of investing on its wireline infrastructure aside from maintaining its wholesale agreement with DTE.

Recommendation:	**SELL**
Vs Previous Recommendation	*N/A*
Price Target FY15:	**11.90 €**
Vs Previous Price Target	*N/A*
Price (as of 21-May-15)	**13.30 €**
Bloomberg: TEF SM	

52-week range (€)	13.86 – 10.84
Market Cap (€m)	65,681.0
Outstanding Shares (m)	4,938.4

Source: Bloomberg



Source: Bloomberg

(Values in € millions)	2014	2015E	2016E
Revenues	50,377	47,146	46,392
OIBDA	15,515	15,294	15,192
Net Profit	3,001	3,734	30,067
EPS	0.61	0.80	0.59
P/E	19.51	14.80	20.28
ROE	12.3%	10.2%	10.5%
EV / Revenues	2.1x	2.3x	2.3x
EV / OIBDA	6.9x	7.0x	7.0x
EV / Op FCF	11.2x	12.6x	12.3x
Dividend Yield	6.3%	6.3%	6.3%
Net Debt / OIBDA	2.9x	3.1x	2.7x

Source: Bloomberg and analyst estimates

THIS REPORT WAS PREPARED BY FRANCISCO MARQUES LOURENÇO, A MASTERS IN FINANCE STUDENT OF THE NOVA SCHOOL OF BUSINESS AND ECONOMICS, EXCLUSIVELY FOR ACADEMIC PURPOSES. THIS REPORT WAS SUPERVISED BY ROSÁRIO ANDRÉ WHO REVIEWED THE VALUATION METHODOLOGY AND THE FINANCIAL MODEL. (SEE DISCLOSURES AND DISCLAIMERS AT END OF DOCUMENT)

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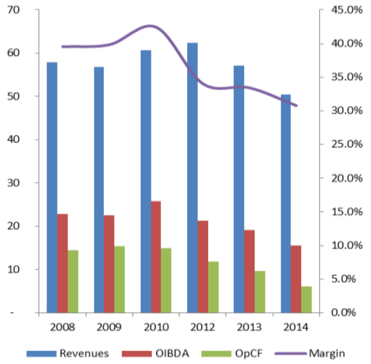

Chart 1 – TEF's operational performance (m EUR) between FY08-14. (Source: Company data).

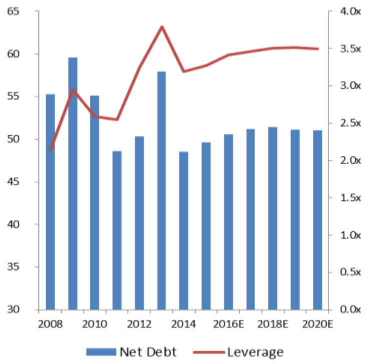

Chart 2 – Net Debt (m EUR) and leverage ratio (Net Debt / OIBDA) between FY08 and FY20e. (Source: Company data).

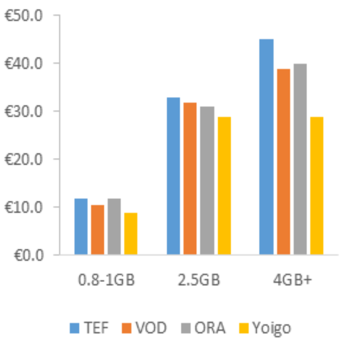

Chart 3 – Mobile contract tariffs in Spain. (Source: Company data).

Executive Summary

We value Telefónica SA (TEF SM) at Eur11.9/share, which, considering an expected dividend payout of Eur0.75 per share in 2015e, corresponds to a negative shareholder return of 3.4% from the current market price of Eur13.3/share, and thus, a sell recommendation for investors.

In our opinion, in the last couple of years Telefónica (TEF) has taken the right steps in order get back to positive YoY growth (see *chart 1*), revamp its profitability and stabilize leverage (see *chart 2*). The telecoms group has focused on the markets where it holds a dominant competitive position (Spain, Brazil and Germany) while divesting from non-strategic operations (O_2 UK, Ireland, Czech Republic and Slovakia), in order to reduce leverage. At a country level, TEF has focused on data monetization by extending its LTE[1] coverage and by offering discounts on LTE-enabled handsets in order to boost data traffic. At the same time, the company has strengthened its wireline offer by investing in high-speed FTTH[2] network (14.7 million houses passed in FY14 in Spain and Brasil) and adding pay TV to 2P[3] and convergent[4] bundles (*Movistar Fusión* portfolio) in order to reduce churn and boost retention.

Despite our positive views on TEF's strategy we are quite bearish regarding the recovery in Spain (48.1% of Group EV), the group's largest and most relevant market. Comparing the commercial portfolio of most significant players in this market, we conclude that TEF is outperformed by its peers in prices and in bundle size (see *chart 3-4*), both in mobile (on average Eur1.6/month higher than competitors for lower-end contract bundles, Eur2.4/month for medium-size tariffs and Eur9.0/month for high-end mobile tariffs) and 4P tariffs (on average Eur4.4/month higher for the lower-end bundles and Eur14.7/month higher for high-end tariffs). For this reason, we expect further market share erosion, in both mobile (5.9pp for 2015e-22e) and FBB (7.7pp), as we consider that consumers will continue to move away from TEF due to its relatively high pricing.

On the other hand, we expect that TEF will benefit from an improving economic backdrop (IMF forecasts an average GDP growth of 1.9% for FY15-22E) and from a more stable pricing environment, following Vodafone's (VOD) acquisition of Ono and Orange's (ORA) takeover of Jazztel (JAZ) seen in 2014. Also, in mobile, this consolidation means lower competition coming from the mobile

[1] LTE, an abbreviation for Long-Term Evolution, commonly marketed as 4G LTE, is a standard for wireless communication of high-speed data for mobile phones and data terminals.
[2] Fibre to the home is commonly referred as FTTH.
[3] 2P refers to fixed broadband and fixed telephony product bundles.
[4] Fixed-to-mobile 4P tariffs includes Fixed Broadband (FBB), Fixed Telephony (FT), Mobile Telephony and Broadband (Voice and Data) and 5P tariffs in case Pay TV is included.

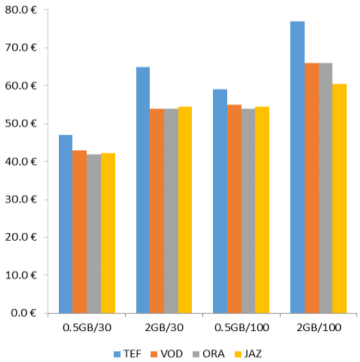

Chart 4 – Comparison of 4P tariffs in Spain based on data allowance (500MB+ or 2GB) and FBB fibre download speed (30 Mbps+ and 100Mps). (Source: Company Data)

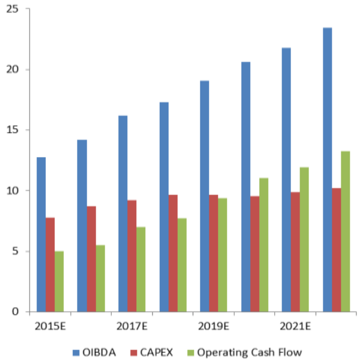

Chart 5 – Outlook for Vivo millions of BRL. (Source: Analyst Estimates)

VIVO	FV
Enterprise Value	**74,501**
(-) Net Debt (FY15)	-965
(+) Non-Op. Assets	8,469
(-) Non-Op. Liabilities	-16,116
(-) Preferred Shares	-44,818
Equity Value	**21,070**
# ON Shares	503.05
Target Price	**41.9**
Current Price	38.10
Upside / Downside	17.1%
Recommendation	**BUY**

Panel 1 – DCF Valuation for Vivo (Ticker: VIVT4 BZ Equity). Source: Analyst Estimates.

virtual operators (MVNO's), led by JAZ and Ono, which have been taking mobile subscriptions from larger operators since 4Q06 (average quarterly net additions of 252 thousand). Regarding bottom-line performance in Spain, we expect a decrease in the OIBDA margin in the near-term (c.44.7% for 2015e-17e, increasing 0.4pp YoY thereafter, on average) due to high handset equipment sales (2.7% CAGR) and increasing TV content and equipment costs associated with the addition of pay TV to the *Fusión* Portfolio in 4Q14. At the same time, we forecast a CAGR of -0.5% for the Operating Cash Flow, negatively affected by the deployment of FTTH (75% houses passed expected for 2016e) and LTE network[5] (85% coverage expected for 2016e).

Furthermore we hold positive outlook over Telefónica Brasil (VIVT3 BZ, FV BRL41.9/share, BUY), mainly due to the expected growth potential[6] coming from the Eur7.2bn takeover of GVT, which allows Vivo to compete with AMX and Oi in 4P products at a country level (29.1% FBB MS), while consolidating its leadership position in São Paulo. From 2015e to 2022e we expect FBB accesses to increase 1.7x to 12.7bn, on the back of high demand for FBB, with penetration levels getting closer to Europe (18.2% expected for 2022e vs. 30.5%[7] EU average) and GVT's high-quality network. Moreover, we expect bottom-line performance to be affected by large capital expenditures associated with the deployment of GVT's fibre network (19.0% of revenue for 2016e-17e) with a positive effect from the combination of Vivo and GVT's wireline network in São Paulo. All in all, considering that, TEF's stake in Vivo decreases from 74% to 70% (following capital increase in 1Q14 for the acquisition of GVT[8]), we estimate a Eur22.0bn Enterprise Value for Vivo, which contributes 16.5% to the Group EV.

Concerning T. Deutschland (O2G GY, FV BRL4.62/share, SELL), we consider that, following the integration of E-Plus in 4Q14, O_2 will be able to sustain its mobile MS (37.4% on 1Q15) in the short-term due to its relatively lower tariffs and the connectivity improvements expected for 2015e with the combination of both company's networks. Nevertheless, considering that O_2 is primarily a mobile operator (90.6% of subscribers, 86.6% of Revenues and a FBB MS of only 8.0%) we are quite conservative regarding the LT growth potential of this operation, as we already see O_2's competitors pushing the market towards convergence, with Telekom and Vodafone adding 906k and 255k customers (respectively) to their convergent 4P tariffs in one year's time.

[5] Currently coverage is 65.0% and the target for 2016e is 85%.
[6] From FY16E to FY22E we expect Vivo's wireline revenues to grown at a CAGR of 9.1%.
[7] Average fixed broadband penetration in European countries using ITU data for 2013.
[8] Telefónica acquired GVT with a combination of Eur4.66bn in cash and a 12.0% stake in an enlarged Telefónica Brasil (after capital increase).

O_2 Deutschland	FV
Enterprise Value	**14,944**
(-) Net Debt (FY15)	-841
(+) Financial Assets	68
(+) Deferred Taxes	581
(+) Other Assets	432
(-) Provisions	-1,117
(-) Other Liabilities	-749
Equity Value	**13,319**
# Shares	2,975
Target Price	**4.5**
Current Price	5.18
Upside / Downside	-7.7%
Recommendation	**SELL**

Panel 2 – DCF Valuation for T. Deutschland (Ticker: O2G GY Equity). Source: Analyst Estimates.

TEF SM	EV	Stake	FV
Spain	**44,803**	**100.0%**	**44,803**
Brazil	**21,330**	**70.0%**	**14,931**
Germany	**14,944**	**62.5%**	**9,340**
Hispanoamerica	**24,994**	**n.a.**	**24,055**
Argentina	2,746	100.0%	2,746
Chile	4,597	100.0%	4,597
Perú	8,554	98.5%	8,426
Colombia	2,703	70.0%	1,892
México	3,660	100.0%	3,660
Venezuela	1,046	100.0%	1,046
Ecuador	1,075	100.0%	1,075
Uruguay	613	100.0%	613
Enterprise Value	**106,071**		**93,129**
(-) Net Debt (FY15)			-57,947
(+) Debt in Minorities			1,199
(+) Equity Investms.			1,293
(+) LT Fin. Assets			13,310
(+) Deferred Taxes			5,579
(+) Sale of O_2 UK			10,200
(-) Provisions			-7,993
Equity Value			**58,771**
# Shares			4,938
Target Price			**11.90**
Current Share Price			13
Upside/Downside			-3.4%
Recommendation			**SELL**

Panel 3 – Sum-of-the-Parts Valuation for Telefónica S.A. (Ticker: TEF SM Equity). Source: Analyst Estimates.

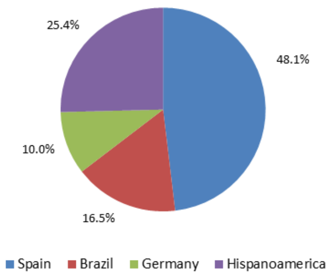

Chart 7 – Enterprise Value per subsidiary.

In sum, since TEF hasn't shown any intentions of investing on its wireline infrastructure aside from maintaining its wholesale agreement with DTE, we are expecting further deteriorating of wireline business revenues (-6.6% CAGR from 2015e to 2022e). In the wireless business however, we expect top-line to grow at a CAGR 0.9% from 2016e to 2022e, with a positive impact coming from mobile data ARPU (2.7% CAGR) and handset equipment sales (8.0% CAGR).

Valuation

The methodology used to arrive at Eur11.9/share was a local-currency Sum-of-the-Parts (SOTP) valuation model using an explicit discount cash flow (DCF) analysis for each subsidiary (see *Panel 2* on the left-hand side). For each country, aside from TEF's performance, we have analysed the evolution of subscribers, penetration rates and MS, as well as the key performance indicators of the most relevant telecoms competing with TEF. For LatAm we used the current exchange rates in order to convert each local-currency EV to Euros, and used forward exchange rates in order to incorporate these cash flows on the forecasted financial statements.

Company overview

Telefónica is Spanish multinational Telecommunications service provider with 341m accesses spread over 16 countries[9] in Europe and Latin America. The company was founded by the Spanish Government in 1924 as Compañía Telefónica Nacional de España, and was privatized in 1997 following the liberalization of the Spanish telecom market. TEF is currently managed by César Alierta Izuel, who holds both the positions of Chairman of the Board of Directors and Chief Executive Officer since 2000.

Company description

TEF's operations are divided into four main groups (see *chart 7*): T. de España (48.1% of Group EV), T. do Brasil (16.5%), T. Deutschland (10.0%), and T. Hispanoamerica (25.4%). At the group level, performance has worsened in recent years, mainly due to TEF's struggling home market (see *chart 8*). Between 2008 and 2014, revenues shrunk 13.1% (-2.3% CAGR) while OIBDA contracted -32.3% (-6.3% CAGR).

In its home market, TEF's profitability has been affected by a weak economic backdrop (-0.71% average GDP growth between 2008 and 2014), regulation (cuts in the mobile termination rate) and high competition, in both wireline and

[9] Spain, Brasil, Germany, Argentina, Chile, Perú, Colombia, México, Ecuador, Uruguay, Venezuela, Guatemala, El Salvador, Panamá, Nicaragua and Costa Rica. Following the of O_2 UK to Hutchison Whampoa

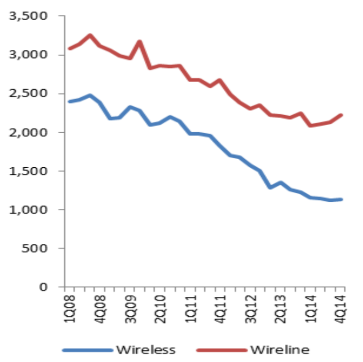

Chart 8 – Wireless and Wireline Revenues (millions of Euros) in Spain (1Q08-1Q14).

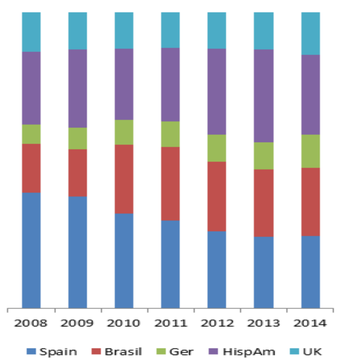

Chart 9 – Weight of each subsidiary in Group Revenues (%) (2008-14)

mEUR (unless noted)	Value	Date	Lev.
O2 UK Wireline (mGBP)	180	6/13	2.5x
O2 Ireland (mGBP)	780	6/13	2.5x
Cent.Am. Assets (mUSD)	500	8/13	2.5x
E-Plus	-8,550	1/14	3.2x
O2 Czech Republic	2,467	1/14	3.2x
4227 Towers (Spain)	385	1/14	3.2x
22% Stake in Digital+	-325	7/14	3.2x
56% stake in Digital+	-707	4/15	3.8x
GVT	-7,693	6/15	3.8x
O2 UK (mGDP)	10,250	6/16	3.2x

Table 1 – Significant M&A activity from Telefónica since 2013 (Source: Bloomberg)

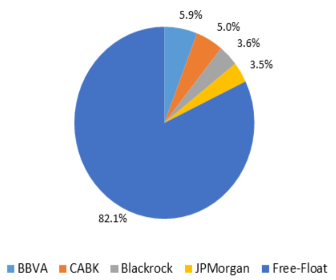

Chart 10 – Shareholder Structure

wireless segments. Consequently, between 2008 and 2014, TEF Spain revenues dropped 42.3% (CAGR of -8.8%), while OIBDA shrunk 44.9% (CAGR -9.5%). At the same time, the relevance of Spain to TEF decreased from 36.0 to 23.9% in terms of revenue (*chart 9*), and from 44.9 to 36.6% in terms of OIBDA.

Furthermore, TEF entered the Brazilian market in 1998, during privatisation of the telecoms sector. In 2002, TEF and Portugal Telecom created a joint-venture which merged all of their existing operations under the name Vivo. Later in 2010, TEF acquired PT's stake in Vivo for Eur7.5bn, and merged its underperforming fixed-line operator Telesp, as part of a fixed-mobile integration strategy aimed at competing directly with AMX in São Paulo. At an operational level, Vivo has helped to offset revenue erosion seen in Spain, with a revenue CAGR of 4.5% (7.9% organically) and an OIBDA CAGR of 0.9% (4.1% in organically) between 2008 and 2014. Subsequently, Brazil's weight on the group revenues and OIBDA increased 7.4pp (to 23.3%) and 8.2pp (to 22.8%), respectively, as we can see in *chart 9*.

Moreover, TEF entered the German market in 2005, through the GBP17.7bn acquisition of mm O2 plc (formerly known as BT Wireless) of which O_2 Germany was part of. In 2009, TEF acquired HanseNet for Eur0.9bn from Telecom Italia in order to lift its FBB, which eventually failed position O_2 as an integrated player (FBB MS below 10%). In 2014, O_2 represented 11.0% of Group revenues in 2014 and 4.7% of Group OIBDA.

In Hispanoamerica, TEF operates in Argentina (2.9% of Group EV), Chile (4.9%), Perú (9.0%), Colombia (2.0%), México (3.9%), Venezuela/Central América[10] (0.7%), Ecuador (1.2%) and Uruguay (0.7%). Together these countries represented 26.1% of group revenues in 2014, 3.7pp higher than in 2008.

In addition, following its deleveraging strategy, TEF has divested from O_2 Ireland (Eur850m), O_2 Czech and Slovakia (Eur2.3bn) and O_2 UK (GBP10.25bn), in order to fund its acquisitions in Brazil, Germany and Spain (Digital+). In *table 1*, we have summarized the most significant M&A movements since 2013, with the estimate leverage ratio for each year.

Shareholder structure

TEF's shareholder structure is composed by BBVA with a 5.9% stake, La Caixa[11] with 5.4%, Blackrock with 3.6%, and by JP Morgan with 3.5% (see *chart 10*[12]). The Board of Directors is composed by 18 members, 5 of which are appointed at

[10] Guatemala, El Salvador, Panamá, Nicarágua and Costa Rica.
[11] Through CaixaBank and La Caixa's Foundation.
[12] Source: Bloomberg

the proposal of the shareholders – 2 by BBVA and La Caixa and 1 by China Unicom, following the Strategic Partnership Agreement established in 2011. The directors of the company hold 0.176% of the total voting rights of the company.

Telefónica de España

	TEF	VOD	ORA
Mobile	34%	28%	29%
FBB	45%	22%	27%
Pay TV	71%	15%	2%
FT	55%	20%	19%

Table 2 – Subscriber MS as of 4Q14 after Consolidation movements

Spain is TEF's biggest and most relevant market with 23.9% of Group Revenues and 36.6% of OIBDA in 2014. Benefiting from its incumbent position, TEF has been the market leader across services[13] (see *table 2*), despite fierce competition from other players, which as lead to successive QoQ subscriber losses in the mobile segment, and MS deterioration in the wireline segment, as we will discuss below. TEF's strategy in Spain has been mainly directed at protecting its OIBDA margin (2.2pp decrease between FY08 and FY14) which stood at 47.2% on 4Q14, significantly above TEF's main competitors – Orange with 24.7% and Vodafone with 24.2%. Hence, as we will discuss further below, Telefónica has remained less keen on lowering its prices than its competitors, which has negatively affected its subscriber base and market share, as we can see in *charts 11 and 12*.

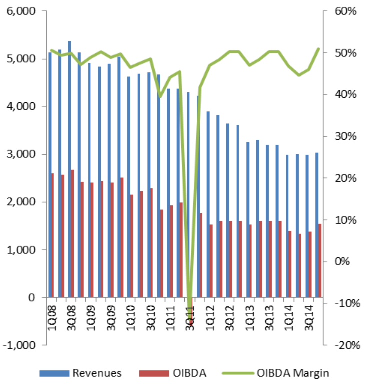

Chart 11 – Performance in Spain from 1Q08 to 1Q14 (Revenues and OIBDA in millions of EUR).

Regarding competition, the two M&A movements seen in 2014 and 2015, namely VOD's Eur7.2bn acquisition of Ono (3.0% mobile MS and 12.8% FBB MS) and ORA's Eur3.4bn deal with Jazztel (3.7% mobile MS and 12.1% FBB MS) has left three large fixed-to-mobile operators –TEF, VOD and ORA – which compete in all 4P services (*see table 2*). In our opinion, consolidation has three significant impacts for TEF: (1) in the mobile segment, consolidation means lower competition coming from MVNO's[14], which have been gaining considerable space in Spain; (2) in the wireline segment, TEF will face tougher competition on its convergent tariff (*Movistar Fusión*) as VOD's and ORA's fixed-line offer is strengthened and (3) reduces long-term price competition in both segments as the market is dominated by only three players. Aside from price stabilization and consequent ARPU protection, we consider that the main rationale for consolidation in Spain was the increasing traction convergent offers[15], which started to be marketed in 2012 by Jazztel, Ono and TEF. Both VOD (8.9% FBB pre-Ono in 4Q14) and ORA (15.3% FBB MS pre-Jazz in 4Q14) lacked sufficient FBB scale in order to effectively compete with TEF (44.9% FFB MS 4Q14), which was in a much more comfortable position to up-sell its 2P/3P customers to *Fusión*.

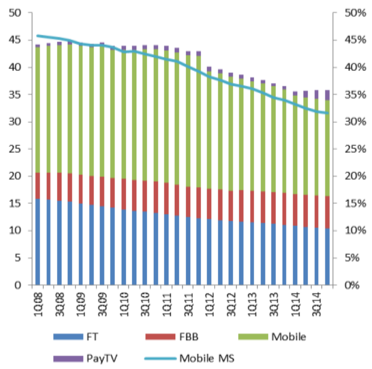

Chart 12 – T. Spain accesses (K)

[13] Fixed Telephony and Broadband, Mobile and Pay TV.
[14] MVNOs stand for Mobile Virtual Network Operators.
[15] As of 4Q14 the penetration of FMC tariffs was 17.3% penetration which corresponds to 8.0bn convergent bundles, according to CMT).

Wireless Segment

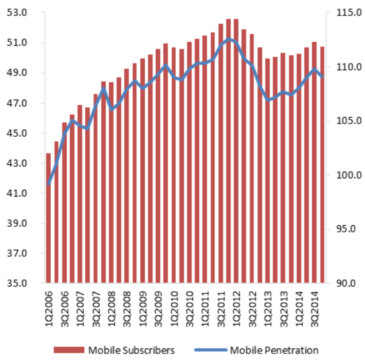

Chart 13 – Mobile subscribers (millions) and penetration (accesses per 100 inhabitants) in Spain (Source: CNMC)

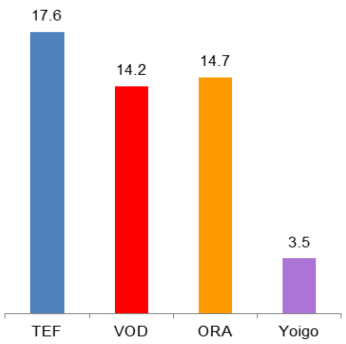

Chart 14 – Mobile accesses as of 1Q15 (Source: Company Data).

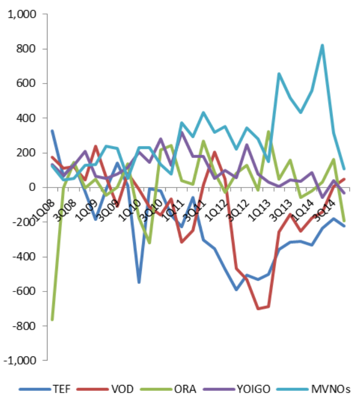

Chart 15 – Mobile net additions in Spain (Source: CNMC)

Room for mobile penetration improvement

In the last 8 years, total mobile accesses in Spain have increased 17.0% (CAGR 1.35%) to 51.1 million (4Q14), which corresponds to 109.8 mobile accesses per 100 inhabitants (see *chart 13*). Penetration had reached its highest levels in 4Q11 with 112.6%, but, due to the worsening of economic conditions seen in 2012 and 2013 (2.1% and 1.2% negative GDP growth, respectively), this figure was reduce to 106.9%, the lowest level seen since 2Q08. At a European level, Spain's ranks remains below average in terms of penetration, which stood at 127.6 in 2014. Going forward we expect penetration Spain to increase to reach 120.0% by 2022, on the back of a more supportive economic environment (1.9% GDP GAGR from 2015e to 2022e[16]). In addition, we expect penetration levels to become more stable (less fluctuation with the economic cycles) as the telecoms sector continues to move towards convergence (in 1Q15 30.6% of TEF's mobile subscribers were in Fusión) which have, inherently, lower churn than mobile-only tariffs (0.9% vs. 1.9%, respectively for TEF in 1Q15).

Larger mobile operators losing space to Yoigo and MVNO's

Taking into consideration the M&A movements in 2014, the mobile market in Spain is dominated by TEF (34.4% MS), VOD/Ono (25.8%), ORA/Jazztel (25.6% with Jazztel) and Yoigo (6.8%) which represent 98.1% of the subscriber base (see *chart 14*). The remaining 1.9% corresponds to group MVNO's which includes Más Móvil and Euskaltel. From 2006 to 2014, this group, which previously included Jazztel and Ono, have been able to take subscribers from the larger operators over the years (see in *chart 15*) due to their very competitive, prepay tariffs.

TEF benefits from consolidation, but not enough to avoid MS erosion

Regarding consolidation, we expect TEF to benefit from consolidation, as they reduce competition from MVNOs, which have been captivating most mobile subscriber's losses from Telefonica, especially in the pre-pay segment - since 2008, when MVNO's started to gain traction, TEF's prepay subscriber base has shrunk 63.2% (vs. a 24.2% reduction of TEF's mobile subscriber base).

Furthermore, in order to evaluate TEF's competitive positioning, we have compared three 4G/LTE post-pay tariffs (TEF's most relevant mobile segment with 82.1% of mobile subscribers and 93.4% of MSR[17]) from TEF, ORA, VOD and Yoigo, based on data allowance, which we consider to be the key driver of

16 According to IMF data
17 MSR stands for Mobile Service Revenues.

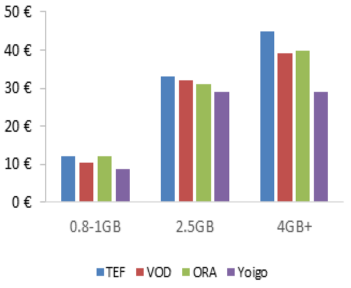

Chart 16 – Mobile Post-Paid Tariffs in Spain (Company data)

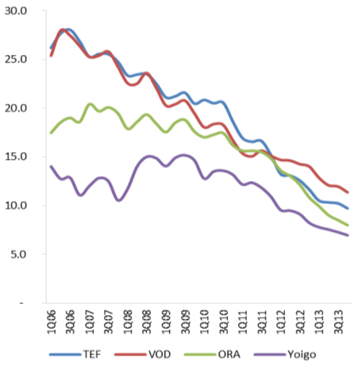

Chart 17 – Mobile voice ARPU (Eur / month / subscriber) in Spain per operator (Source: CNMC)

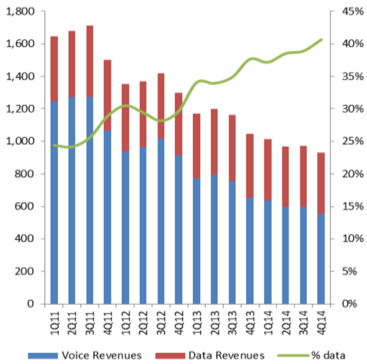

Figure 18 – Voice vs. Data Revenues (m EUR) in TEF Spain between 1Q11 and 4Q14.

this segment. As we can see in *chart 16*, Yoigo's mobile contract tariffs are considerably cheaper to the ones offered by TEF, VOD or ORA[18]. Also, Yoigo retails a bundle with unlimited voice minutes and data usage for Eur29.9/month which is, on average, Eur3.0/month cheaper than any 2.5GB bundle offered by Movistar (Eur33.0/month), ORA (Eur31.0/month) or VOD (Eur32.0/month). In sum, we do not consider that the benefit coming from consolidation will be enough to offset TEF's less competitive tariffs, specially comparing with Yoigo. Additionally, we do not expect TEF to engage in price competition, since its long-term strategy has been margin protection. Hence, considering the reduction of MVNO's we believe that TEF will sustain its prices above ORA, VOD and Yoigo, leading to a further market share deterioration. Consequently, between 2015e and 2022e, we expect a 5.6pp MS reduction to 27.2%, with mobile subscriptions decreasing at a CAGR of 2.0%.

ARPU - growing relevance of data as operators seek to monetize data

Over the last years, intense price competition from MVNO's, together with regulatory cuts in the MTR[19], had a negative pressure on mobile voice ARPU across operators (see *chart 17*). However, we consider that mobile communication habits in Spain are shifting from voice/ SMS to data: since 1Q12, data consumption per subscriber (in Spain) increased 185.2% (154 to 439 MB/month) while voice traffic per subscriber (MOU[20]) increased only 22.0% (114 to 139 minutes/month) and SMS traffic per subscriber decreased 60.1% (10 to 4 texts/month). Hence, going forward we expect data to become the main driver of MSRs, with consumers moving away from voice and SMS to OTT services such as *WhatsApp*. At the same time, we expect mobile operators to continue to push for data monetization by investing in LTE network and subsidizing smartphone equipment in order to boost data traffic and, consequently, data ARPU. On the revenue side, we expect a negative pressure on as mobile operators continue to stretch customer data allowances and, at the limit, provide high-end tariffs with unlimited data, following Yoigo's move in 2014.

For TEF, data revenues already account for 38.8% of 2014 MSR, 13.1pp higher than in 2011, as we can see in *chart 18*. In contrast with voice ARPU (-33.3% FY11-14), data ARPU has improved 22.2% (FY11-14), on the back strong traffic growth, which has offset lower average revenue per MB (due to successive increases of the data allowances). With smartphone penetration currently at

18 For a small data cap bundle, Yoigo charges Eur8.80/month for 1.2GB of data, whereas VOD charges Eur10.50/month for 800 MB, ORA charges Eur11.95/month for 1GB and TEF charges Eur12/month for 1GB. For the medium 2.5GB and the large 4+GB bundles, Movistar continues to price its post-pay tariffs higher than its competitors at 33 and Eur45/month, respectively. In contract, Yoigo prices its unlimited voice and mobile tariff at Eur29/month

19 78.3% cut from 4.98 Eurocent/minute in 2012 to 1.09 in 2013

20 Minutes of Use – average voice traffic (measured in minutes) per subscriber per month.

62.8%[21] (75.6% for contract subscribers) and LTE penetration at 13.7% (2.2m subscribers) we consider that there is significant room for data traffic growth since LTE-enabled equipment is estimated to consume 3x more data than 3G handsets[22]. Hence, going forward, we are assuming a CAGR of 3.6% for data ARPU, on the back of higher data usage per subscriber as LTE penetration increases, with a short-term negative impact coming from lower average revenue per MB as we expect further increases on the data allowances for each tariff. Furthermore, we expect that the blended ARPU will continue to be negatively impacted by deteriorating voice ARPU which has decreased 26.6% between 2012 and 2014, due to a combination of regulatory cuts on the MTR (73.2% cut since 2012) and relatively flat MOU (16.0% growth between 2012 and 2014 vs. 36.7% decrease on the ARPM[23]). In addition, we estimate a CAGR of -7.6 for voice ARPU, due to lower interconnection revenues (in the short-term as operators suffer from a lower MTR) and due to the voice-for-data substitution described above.

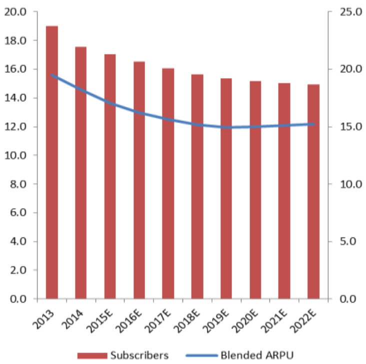

Chart 19 – Subscribers (millions) and ARPU (EUR / subs / month) outlook for TEF Spain (Source: Analyst Estimates).

Outlook - Not enough data monetization to fuel recovery

In light of our estimates in terms of mobile subscribers and ARPU we estimate a CAGR of -4.2% for MSRs from 2015e to 2022e (vs. -6.2% 2009-14) with negative YoY growth until 2020e. We are assuming a progressive decline in YoY revenue erosion on the back of the data monetization efforts that we have previously discussed. Nonetheless, considering TEF's relatively expensive mobile tariffs we forecast further subscriber losses (300 thousands per year on average for 2015e-2022e vs. 1000 FY09-14) as customers continue to switch for cheaper alternatives (*chart 19*).

Wireline Segment

In the Wireline segment TEF provides Broadband (FBB), Pay TV and Fixed Telephony (FT) at a country level. As we will discuss further below, TEF has maintained a strong foothold with a MS of 55.3%[24]. In terms of revenues, Wireline Business represented 71.1% of TEF Spain's 2014 revenues and 57.3% of total accesses.

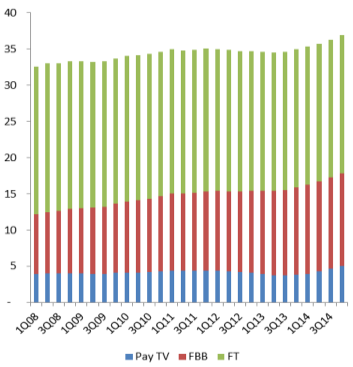

Chart 20 – Evolution of wireline services (millions of accesses) in Spain since 2008. (Source: CMT)

Market overview – Operators push for 4P

Furthermore, most of wireline services are sold together in bundles, either 2P (FBB and FT), 3P (adding Pay TV) or 4P (adding Mobile). Since the first convergent tariffs were first introduced in 2012 by JAZ and TEF, most of 2P and

21 According to data from the 1Q15 results report and presentation.
22 According to data from Telefónica's 1Q15 report.
23 Average Revenue per Minute
24 Including Broadband, Pay TV and Fixed Telephony accesses

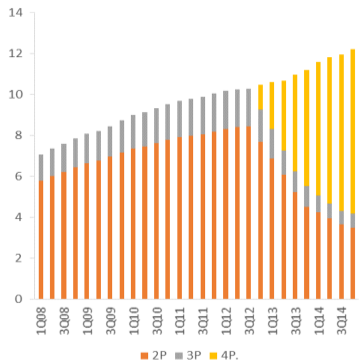

Chart 21 – Evolution of 2P/3P/4P (millions of accesses) in Spain since 2008, in terms of packages in which this service is sold (Source: CMT)

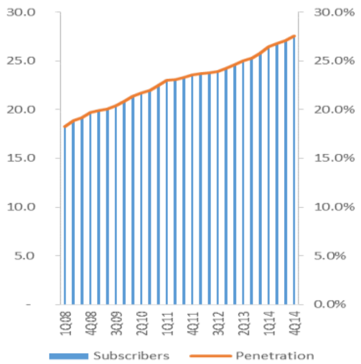

Chart 22 – Evolution of FBB accesses in Spain since 2008 (millions).

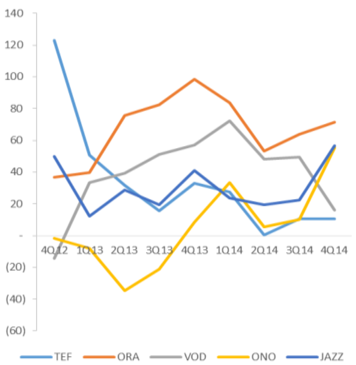

Chart 23 – FBB net adds (thousands) between 4Q12 and 4Q14. (Source: CMT)

3P costumers have switched away to 4P (see in *chart 21*), with convergent offers reaching household penetration of 44.0% in 2014. In terms of accesses, 4P now accounts for 62.6% and 42.1% total FBB and FT accesses, as well as, 43.5% of total Pay TV subscriptions. Consequently, in order to understand the competitive environment of wireline services in Spain, we will concentrate our price analysis on convergent tariffs rather than 1P, 2P or 3P prices.

Moreover, from the three wireline services that TEF provides, we will look closer at FBB, as we consider it to be the key driver of 4P bundles, due to its increasing demand in last the last years. Between 2008 and 2014, FBB accesses increased 44.3%, reaching a household penetration of 70.1%, whereas, FT accesses shrunk 6.5% over the same period, in line with a fixed for mobile telephony substitution trend seen in most European countries. Pay TV, despite a 25.8% increase in subscriptions, has gained little traction in Spain (household penetration at 27.7%) mostly due the high popularity of open television[25]. Besides, the positive growth in Pay TV described above came from subscriptions included 4P tariffs, as accesses included in 2P and 3P tariffs decreased 28.9% over the same period. Going forward, we expect FBB, FT and Pay TV subscriptions to converge, as 4P penetration continues to improve (currently at 17.3%).

Market overview - demand for high-speed connections drives fibre roll-out

From 4Q08 to 4Q14, FBB penetration per 100 inhabitants increased from 12.4 to 28.6% (see *chart 22*). Similar to what we have seen in mobile, Spain ranks below OECD average, which stood at 29.4% in 2Q14. Likewise, we believe this gap will shrink and FBB penetration will increase to 38.1% by 2022, as providers continue to deploy high-speed technology network, such as FTTH, in order to increase service quality (FBB connection speed seen in Spain[26] is relatively low) and reduce long term costs.

Competition – TEF losing MS YoY despite growing subscriber base

Following the consolidation of the telecoms sector seen in 2014/15, there are four players that represent 94.7% of the FBB subscriber base – TEF (45.6% MS), ORA/Jazztel (27.4%) and VOD/Ono (21.7%). Apart from Ono, operators have enjoyed consecutive positive QoQ net additions (see *chart 23*), benefiting from the growing demand for FBB. TEF, despite being largest player in the segment and having a growing subscriber base, has been losing space to ORA, JAZ and

[25] This can be explained by the fact that open TV in Spain includes 33 free channels.

[26] In 1Q13, 60.7% of broadband accesses had a connection speed below 10 Mbps broadband speeds. The reason for this lack of investment is that Telefónica had enjoyed an above 50.0% market share for a long time (until 2Q13), and thus there was little incentive to invest in fibre since the company would face significant regulatory hurdle, and would probably be forced to share its FTTH network with its competitors. However, this scenario changed when TEF's saw its market share fall considerably, mostly to ORA, VODA and JAZZ, which led TEF to invest considerably in fibre, as a way to increase the quality of its portfolio and avoid cutting its price points even further.

VOD[27], due to its relatively high tariffs, as well as, its reluctance to engage in any kind of price competition. In our view, TEF has remained focused at protecting its price points, mainly by adding Pay TV to its bundles, as it did on the cheaper *Fusión* tariffs in 2014. In addition, in 1Q15, Telefónica rose the price of all *Fusión* tariffs by Eur5.0/month, expecting to benefit from consolidation, which signals its strategy to protect its prices and margins.

Competition – *Fusión* is, on average, Eur8.2/month more expensive

In order to have a forward looking view regarding the competitive positioning of 4P operators in Spain, we have compared four types of convergent bundles sold by TEF (*Fusión*), ORA (*Canguru*), VOD (*One*[28]) and JAZZ (*Ahorro*) based on FBB download speed and mobile data allowance, which we consider to be the key differentiators for consumers (see *table 3*[29]).

	(1)	(2)	(3)	(4)
TEF	30Mbps / 500 MB	30 Mbps / 2 GB	300 Mbps / 500 MB	300 Mbps / 2 GB
VOD	30Mbps / 1 GB	30Mbps / 2 GB	120 Mbs / 1 GB	120 Mbps / 2 GB
ORA	50 Mbps / 1 GB	50 Mbps / 2.5 GB	100 Mbps / 1 GB	100 Mbps / 2.5 GB
JAZ	50 Mbps / 1.1 GB	50 Mbps / 2 GB	200 Mbps / 1.1 GB	200 Mbps / 2 GB

Table 3 – Fixed broadband download speed and data allowance included in each Convergent Tariff chosen for the price comparisons. (Source: Company Data)

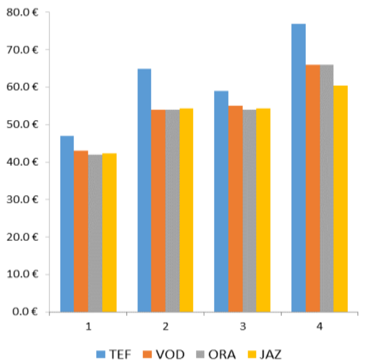

Chart 24 – Comparison of Convergent Tariffs in Spain based on mobile data allowance (500MB+ or 2GB) and Broadband fibre download speed (30 Mbps+ and 100Mps). (Source: Company Data).

As we can see in *chart 24*, for all four bundles that we have compared, TEF is pricing its 4P portfolio above its peers and does not offer any significant advantage in terms of mobile data and FBB download speed (see *table 3*). For example, TEF's flagship bundle (*Fusión Contigo TV*) is, on average, Eur4.6/month more expensive than the other three offers[30] and, in terms of specifications (table 3), includes a smaller data allowance and falls behind ORA and JAZ in terms of FBB download speed. Moreover, for a larger mobile data allowance (2 GB) TEF charges customers an additional Eur18.0/month whereas its competitors charge, on average Eur11.7/month[31]. In terms of FBB, all four operators charge an additional Eur12.0/month (from bundle 1) for an upgrade to at least 100 Mbps download speed. Hence, we consider TEF is outperformed by its peers both in terms of price and specifications.

Outlook - growth in FBB subscribers despite falling market share

Nevertheless, in the short-term, we expect TEF to benefit from its large FTTH footprint (11.5m houses passed vs. 8.5 from VOD, 3.7 from JAZ and 0.9 from

[27] As a result 2012 to 2014, TEF's subscriber base increased 5.36% while ORA's base increased 40%, JAZ's 17% and VOD's 43%.

[28] One is Vodafone's first convergent tariff after the integration of Ono. Jazztel and Orange still have separate commercial offers and, for that reason, we have analysed both convergent tariffs.

[29] 1) Small fixed (30 Mbps fibre/ADSL) and small mobile (LTE 500MB+). 2) Small fixed (30 Mbps fibre/ ADSL) and large mobile (LTE 2GB). 3) Large fixed (100 Mbps fibre) and small mobile (LTE 500MB+). 4) Large fixed (100 Mbps fibre) and large mobile (LTE 2GB).

[30] Vodafone's One is Eur43.0/month; Orange's Canguru is Eur42.0/month and Jazztel's Ahorro is 42.28/month.

[31] Vodafone charges Eur11.0/month for an additional 1GB; Orange charges Eur12.0/month for an additional 1.5GB and Jazztel charges Eur12.1/month for an additional 1GB.

	FTTH	LTE
TEF	63.0%	65.0%
VOD	46.6%	75.0%
ORA	4.9%	73.0%
JAZ	20.1%	73.0%*

Table 4 – FTTH and LTE coverage in Spain per operator. *Jazztel is a MVNO and therefore does not own a LTE network of its own. The 73.0% LTE coverage corresponds to Orange's network (with whom JAZ has the MVNO agreement. (Source: Company Data)

ORA) as we can see in *table 4*. Going forward, however, we consider that VOD posts the biggest threat to TEF, due to its lower prices, large FTTH scale and its leading position in terms of LTE coverage. In addition, in urbanized areas, where fibre coverage is typically higher, we expect TEF to loose space also to Jazztel, which we consider to be the best value-for-money offer in the market today (see *table 3* and *chart 24*). Furthermore, it is still unclear how ORA will relaunch its 4P/5P tariffs after the integration of Jazztel is fully completed. Nonetheless, Orange mentioned its strategy is to grow its top-line by enlarging its subscriber base rather than increase its prices. Hence, we consider the combination of the two operators will create a very strong opponent to VOD and TEF, as it will combine ORA's well-developed mobile network (73.0% LTE coverage) and Jazztel's growing fibre network (10m homes passed expected for FY16 which corresponds to a coverage of 54.5%).

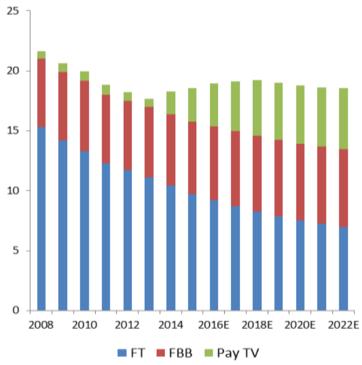

Chart 25 – Outlook for TEF's wireline accesses (millions) in regards to IPTV, Fixed Broadband and Fixed Telephony. (Source: Analyst Estimates)

Consequently, we are assuming in our forecasts that TEF will continue to lose MS to VOD and JAZ/ORA. The key trigger for our bearish outlook over TEF's position view comes from the pricing movements seen in 1Q15. Firstly, TEF raised by Eur5.0/month the price of its 4 *Fusión* tariffs in anticipation of a more stable pricing environment following consolidation. Secondly, after the integration of Ono in 1Q15, VOD re-launched its convergent portfolio (*One*) which, as we previously mentioned, significantly underpriced TEF's portfolio. In our opinion, these movements signal two opposing strategies by the two operators: 1) TEF's push for margin protection and 2) VOD's willingness to increase its MS in FBB (currently at 21.7%) by offering better deals than TEF. All in all, in terms of valuation, we forecast that FBB accesses will grow at a 1.3% CAGR, between 2015e-22e, with a 7.4pp market share deterioration over the same period. In the short-term, however, we consider that TEF will benefit its larger fibre coverage at the same time that demand for FBB continues to increase (see *chart 25*).

Acquisition of Digital+ allows reduction of long-term TV content costs

Between 2014 and 2015, TEF accumulated a 78.0% stake in the Digital+[32] for a total of Eur1.0bn. This company provides satellite pay TV service to 1.7m consumers (33.5% MS in 4Q14) and wholesales content to other pay TV providers. In our opinion, this acquisition has two important effects for TEF: 1) gives TEF a dominant position in pay TV with a subscriber MS of 70.7%; 2) enables a reduction in LT content costs as sufficient scale is reached. On the other hand, due to regulatory remedies, TEF was forced to wholesale 50% of Digital+'s premium content over to its competitors which, in our opinion, significantly reduces the strategic benefits of this acquisition in terms of content

32

exclusivity. Hence, we do not expect TEF to create add value to its 4P portfolio by marketing additional premium content since its competitors can obtain this content at the wholesale level. In addition, we recall that, due to the large number of open television channels in Spain, the relevance of Pay TV is still small (household penetration at 27.2%). Therefore, considering that TEF will have to provide its competitors with 50% of its premium content, we consider that this acquisition will be neutral at the top-line. Nonetheless, we are including in our valuation costs savings going forward, as TV content costs are reduced.

Positive YoY top-line growth expected for 2017e

Moreover, we assume that consolidation will have a long-term positive effect on residential ARPU, which has fallen 22.1% from 2011 to 2014, according to our estimates. In addition, we expect a positive impact coming from the addition of pay TV to the *Fusión offers*, which provides an additional revenue stream for the same DSL/Fibre connection. For our forecasting period we assume a CAGR of 1.5%, with negative YoY growth until FY16E. Moreover, from 2015e to 2022e we are forecasting top line growth of 0.7% (CAGR), on the back of broadband ARPU stabilization (0.2% CAGR) and TEF's large coverage in an environment of growing demand for FBB.

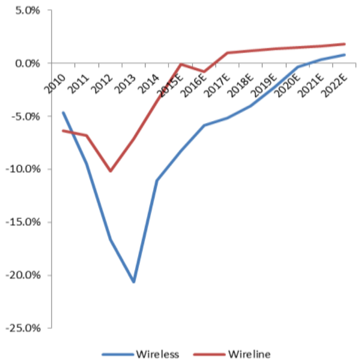

Chart 26 – YoY revenue growth of TEF Spain's Wireless and Wireline Segment from 2010 to 2022e. (Source: Analyst Estimates and company data)

Valuation

Considering our analysis for the wireless and wireline segments we are quite bearish regarding growth potential for TEF in Spain. From 2015e to 2022e we forecast negative revenue CAGR of -0.3%, with top-line deteriorating until FY19e (see *chart 26*). From then on, we expect that the recovery in the wireline segment (on the back of higher FBB demand and ARPU stabilization) will offset the poor performance of the wireless segment. At the OIBDA level, we are assuming YoY negative growth until FY17e, due to an adverse effect of TV content/equipment (due to Fusión additions and up-selling from 2P customers to 4P) and handset equipment sales (as part of the data monetization strategy) on the margin. From FY18e onwards we consider that the OIBDA margin will be positively affected by lower content costs, as TEF reaches sufficient scale in pay TV, and lower operating costs as ADSL customers are moved to the more cost-effective fibre-network (see *chart 27)*. Regarding bottom-line performance, we expect that the expansion of fibre (currently coverage is 63.0% and the target for 2016e is c.75.0%[33]) and LTE networks (currently coverage is 65.0% and the target for 2016e is c.85.0%[34]) will lead to high levels of Capex until FY18e at 19.1% of revenues (on average), stabilizing at 15.5% by the end of our forecasting period

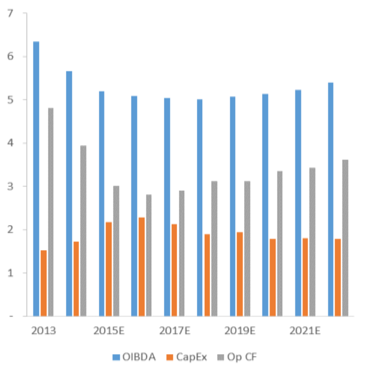

Chart 27 – Outlook for TEF Spain in terms of OIBDA, Capex and Operating Cash Flow in millions of Euros. (Source: Analyst Estimates)

[33] According to company guidance provided in results presentations.
[34] According to company guidance provided in results presentations.

(see *chart 25)*. Assuming a WACC of 7.1% and a terminal growth of 1.5% we value Spain at Eur44.8bn, which corresponds to 48.1% of the total Group EV.

Telefônica do Brasil

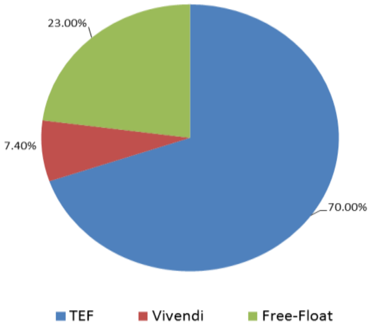

Chart 28 – Shareholder Structure of TEF Brasil following the capital increase of 1Q15. (Source: Company data)

Telefônica do Brasil (Vivo), with 22.3% of Group revenues and 22.8% of Group OIBDA, is TEF's second largest operation worldwide. Following the Eur7.7bn (Eur4.7bn in cash and 3.0bn in stock) of GVT[35] TEF will hold a 70% controlling stake[36] (see *chart 28*) in Vivo which trades (VIVT3 for common shares and VIVT4 for preferred shares) on the São Paulo Stock Exchange (Bovespa) with an estimated free-float of 23.0%. We value Vivo (VIVT3 BZ) at BRL41.9/share which corresponds to a positive shareholder return of 17.2% from the current market price of Eur38.1/share, considering an expected dividend payout of BRL3.6/share for ON shares and BRL3.7/share for PN shares announced for FY15e. The trigger of our buy recommendation comes from the expected growth potential following integration of GVT, which allows Vivo to expand its wireline business outside of São Paulo. Considering the current relatively low FBB penetration of 11.8% (vs. 29.4% in Europe), a positive economic environment (1.8% average GDP growth for 2015-22e), high appetite for this service (18.8% Subscriber CAGR between 2007 and 2014) and Vivo's presence in 17 states (84% of the population) we consider that there is a substantial growth opportunity in this country, as we will try to demonstrate below.

Wireless Segment

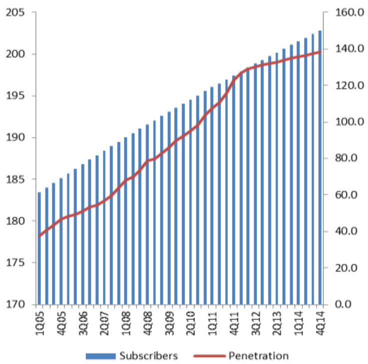

Chart 29 – Evolution of mobile subscriptions (millions of accesses) and penetration (accesses per 100 inhabitants) in Brazil from 1Q05 to 4Q14. (Source: Anatel)

Market overview - appetite for mobile

Since the beginning of the 20th century, Brazil has experienced an impressive evolution in the telecommunications sector with accesses and penetration rates climbing across services, reaching North American and European levels. From 4Q05 to 4Q14, mobile accesses in Brazil increased 309.0% (CAGR 15.5%) with mobile penetration jumping almost 100pp to 140.2% (see *chart 29*), which is considerable higher than the OECD average of 124.8. In our opinion, this relatively high penetration is explained by the large price differential between off-net and on-net tariffs, leading consumers to hold more than one active mobile prepay SIM card, which explains the high relevance of the prepay segment in these country (76.1% vs. 28.8% in Spain and 49.5% in Germany). Going forward,

35 This acquisition is expected to be completed in 2Q15,

36 Telefónica currently holds 92% of ON shares and 65% of PN shares which corresponds to 74% total shares. According to the terms of the deal with Vivendi, TEF will acquire GVT for a cash component of Eur4.7bn, which is finance d through a capital increase at Telefónica Brasil, and a 12% stake in the enlarged Telefónica Brasil. In addition, TEF will exchange 1,110m shares of Telecom Italia for 4.5% stake in the enlarged Telefónica Brasil. All in all, the capital structure of Telefonica Brasil will be: TEF with 70%, Vivendi with 7.4% and a remaining free-float of 23%.

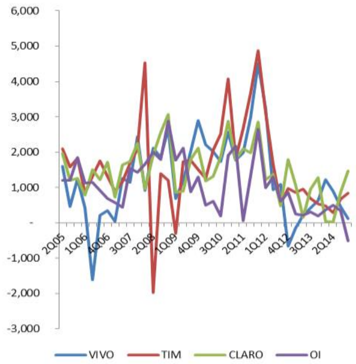

Chart 30 – Evolution of net additions per operator (thousands of accesses) in Brazil from 1Q05 to 4Q14. (Source: Company Data; Anatel)

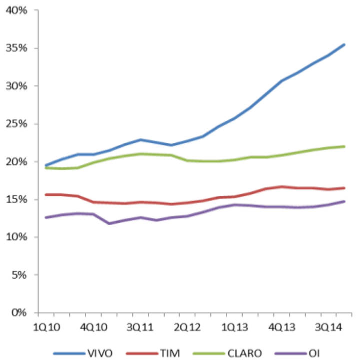

Chart 31 – Post-Pay accesses per operator as a percentage of total subscribers in Brazil from 1Q10 to 4Q14. (Source: Company Data)

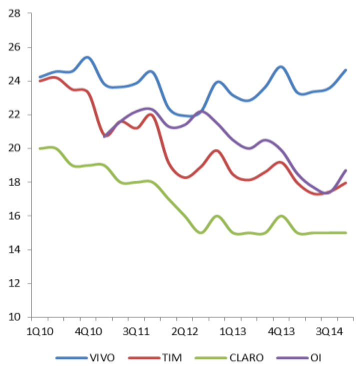

Chart 32 – ARPU (BRL / Subscriber / month) per operator in Brazil from 1Q10 to 4Q14. (Source: Company Data)

due to the relatively high penetration seen at the moment, we expect YoY growth of mobile accesses to keep shrinking, with penetration stabilizing around 147.0% by 2022e.

Claro and TIM close behind Vivo

The Brazilian mobile market is dominated by Vivo (28.5% MS), TIM (27.0% MS), Claro (25.3% MS) and Oi (18.1% MS) which account for 98.8% of total subscribers. At a country level, from these mobile network operators, Claro has the highest coverage (92.1%) followed by TIM (91.5%), Vivo (91.3%) and Oi (88.6%). Following the general pace of this segment – both high population and penetration growth – these operators have enjoyed positive QoQ net additions in the last 10 years, as we can see in *chart 30*. Hence, subscriber market share has been determined by how fast these players are able to grow their mobile subscriber base. Consequently, Vivo, with an 11.1% subscriber CAGR between 1Q05 and 4Q14, has seen its market share fall by 15pp. Claro and TIM, with average annual growth of 18.1% and 17.7% have increased their market share by 5.6pp and 4.6pp, respectively, threatening Vivo's leadership in mobile.

Nevertheless, Vivo's weak performance in terms of MS can be explained by its focus on post-paid subscribers, which have a 4 times higher ARPU than pre-paid[37]. As we can see in *chart 31*, from 1Q10 to 4Q14, Vivo's post-paid base jumped from 16.0pp to 35.5%, at the same time the percentage of contract subscribers of TIM, Claro and Oi increased only 2.0pp (on average). Consequently, Vivo is, by far, the market leader in post-pay with 44.2% of total contract subscriptions in Brazil (followed Claro with 24.4%, TIM with 19.5% and Oi with 11.7%). In the pre-pay segment, however, Vivo has been relegated to the third place with a 24.1% market share, behind TIM (29.6%) and Claro (26.0%). Going forward, we expect Vivo to continue to focus on migrating it's prepay subscriber to contract in order to reduce its relatively high churn (2.9% vs. 1.8% in Spain 2.4% in Germany and 1.7%) and protect its ARPU.

Vivo's focus on high-value customers pays off in terms of MSR

Average ARPU among Brazilian operators decreased 16.6% in the last 5 years, mostly affected by a large pre-paid costumer base (76.1% of total), regulatory cuts in MTR and an intense competitive environment. Nonetheless, Vivo has been more effective than its competitors at protecting ARPU, mostly due to its focus on post-paid subscribers – see *chart 32*. Between 1Q10 and 4Q14, Vivo's ARPU increased 1.7% whereas TIM's ARPU fell 25.2% and Claro's ARPU decreased 25.0%. Consequently, Vivo's focus on high-value customers has paid-

[37] In 4Q14, Vivo's post-paid ARPU was BRL50.0/month, almost 4 times higher than pre-paid ARPU (BRL12.8/month in the same quarter).

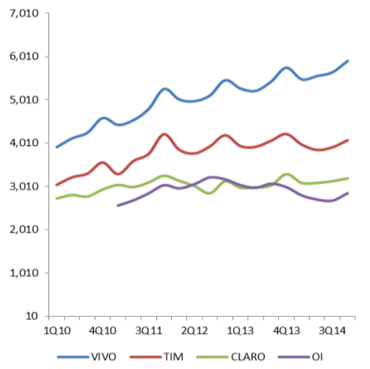

Chart 33 – MSRs (m BRL) per operator in Brazil from 1Q10 to 4Q14. (Source: Analyst Estimates)

off in terms of MSR as we can see in *chart 33*. Between 1Q10 and 4Q14, MSR have grown at a CAGR of 7.7% (vs. 5.0% from TIM and 2.8% from Claro) making Vivo the best performer (see *chart 31*) at the top line with a MS of 36.8% (vs. TIM with 25.4%, Claro with 24.4% and Oi with 17.8%).

Operators set eyes on LTE in order to boost data revenues

Another pin-point of Vivo's strategy is data monetization[38]. Since the LTE spectrum auction in 2012, for which Vivo paid BRL1.1bn, coverage has reached 42.5% of the population, according to Anatel data for 1Q15. Vivo has the largest LTE coverage with 40.8%, in front of Claro (37.1%), TIM and Oi (both with 35.5%). Correspondingly, Vivo held the highest percentage of LTE-enabled devices with a LTE subscriber market share of 37.6%, followed by TIM (32.2%), Claro (19.7%) and Oi (7.6%). At the top-line, the effects of data for Vivo have been evident – from 1Q12 to 1Q15 data revenues increased 48.1% with data ARPU contributing 39.1% to the blended ARPU (20.3 pp increase). Going forward, assuming that TEF continues to expand its LTE coverage, we expect a strong growth for data revenues (CAGR of 9.8% from FY15e to FY22e) on the back of growing data usage per subscriber, which is still relatively low at 281 MB per month (vs. 496.5 in Spain, 333.1 in Germany and 438.1 in the UK).

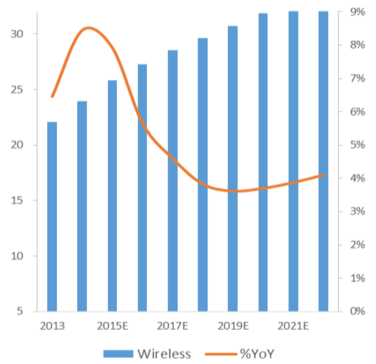

Chart 34 – Wireless Revenues forecast (m BRL) and expected YoY growth. (Source: Analyst Estimates.)

Outlook - focus on data offsets loss of pre-paid subscribers

From 2015 to 2022 we forecast a CAGR of 9.6% for wireless revenues (*chart 34*) and a CAGR of 1.6% for mobile subscriptions. On the revenue side, we expect positive contribution coming from data, as Vivo continues to invest heavily on LTE coverage expansion. In addition we assume a positive contribution coming from equipment sale, as Vivo continues to subsidize the sale LTE-enabled smartphones, as part of its plan to monetize data. In terms of subscribers, we assume a reduction in the mobile market share of Vivo due to a lower pre-paid subscriber base. In the post-paid segment we expect Vivo to remain the largest operator, which we consider to have a very positive impact on ARPU.

Wireline Segment

Exponential growth in Broadband

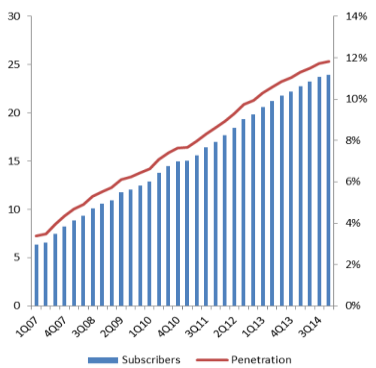

Chart 35 - Evolution of FBB subscriptions (millions) and penetration (per 100 inhabitants) in Brazil from 1Q05 to 4Q14. (Source: Anatel)

Similar to what we have seen in the mobile segment, there has been an exponential growth in FBB in Brazil (see *chart 35*). From 1Q07 to 4Q14, FBB accesses grew 276.7% to 24.0m (CAGR of 18.1%), with penetration jumping from 3.4 to 11.9% per 100 inhabitants. Nonetheless, there is a considerable discrepancy within federal states, as most of the investment in FBB network has

[38] According to information given during the conference call on February 2015

been directed to urban areas. Out of the 27 states, 16 have a penetration rate lower than 6%. At an international level, Brazil ranks above the average for Latin America (10.9%) but it still considerable below the European average (29.4%). Going forward we expect penetration levels to continue to increase at a strong pace on the back growing demand for this service and a supportive economic environment (average GDP 1.8% expected from FY15e-22e).

América Móvil continues ahead of Oi

	#UF	% Pop	MS
AMX	20	92%	31%
OI	26	78%	27%
VIVO	1	22%	17%
GVT	16	84%	12%
VIVO+GVT	17	84%	29%

Table 5 –Number of UF's (*Unidades Federativas)* covered by each operator, and % of the total population that can be covered. (Source: Anatel and Analyst Estimates)

Regarding competition, there are four large FBB providers which account for 88.1% of total FBB accesses at a country level: América Móviles (AMX), Oi, Vivo and GVT. As we can in *table 5*, operators are not present in all of the 27 federal states and thus, they may not compete directly in region where they own a FBB infrastructure. AMX is the largest player in this segment with 7.5m subscribers on 4Q14 (31.4% MS)[39]. This company operates in 16 federal states (including São Paulo and Rio de Janeiro), which corresponds to 91.9% of the population[40]. Oi is second largest provider with 6.6m FBB subscribers (27.3% MS)[41]. Oi's is present in 26 states (all except São Paulo) which corresponds to 78.3% of the population. Vivo is the third largest FBB provider with 3.9m accesses (17.1% MS). However, Vivo operates only in São Paulo, Brazil's most populated state with 44m inhabitants (21.7% of total), where it holds a subscriber market share of 46.1% (4Q14). The fourth largest operator is GVT, which operates in 16 states (83.8% of the population including São Paulo and Rio de Janeiro) with 2.9m accesses in 4Q14 (83.8% MS). These operators have followed the general pace of the market, with general positive YoY growth. In addition, as we can see in (see *chart 36*), between 1Q07 and 4Q14, Claro (average subscriber growth of 42.2%) and GVT (47.1%) have been taking market share points, at the expense of Vivo (10.4%) and Oi (11.4%).

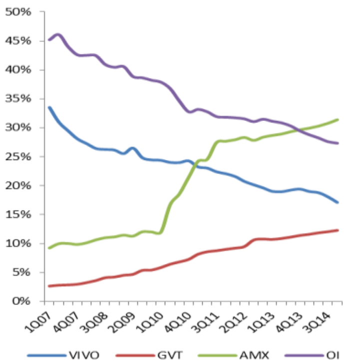

Chart 36 - Evolution of Broadband MS (accesses) in Brazil from 1Q07 to 4Q14. (Source: Anatel)

3P drives fixed telephony

In contrast with FBB and mobile, FT accesses have remained mostly stable between 2007 and 2014 with penetration lingering between 20.8% and 22.2%. In this segment, Oi is the largest operator with 36.2%, followed by AMX (25.9%), Vivo (23.5%) and GVT (10.2%). Competition movements are similar to what we have seen in FBB with AMX and GVT gaining space from Oi and Vivo. We expect that this segment will be mostly driven by FBB, especially in urban areas, as consumers move to 3P bundles.

39 Since the commercial release of broadband packages in 2005, NET has able to increase its market share YoY, with an impressive CAGR of 42.3% for its subscriber base.

40 NET's market share in these 16 states is 32.7%

41 The company's market share excluding São Paulo, the only state where Oi is not present, is 43.5%

Momentum in Pay TV

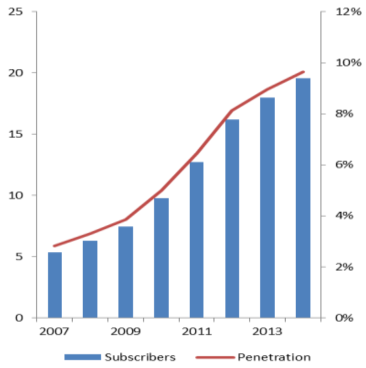

Chart 37 - Evolution of Pay TV subscriptions (millions of accesses) and penetration (accesses per 100 inhabitants) in Brazil from 2007 to 2014. (Source: Anatel)

Regarding Pay TV, between 2007 and 2014, subscriptions increased 365.8% (CAGR 20.6%) to 19.6m, with subscribers per 100 inhabitants reaching 9.7% (*chart 37*). In an environment of growing subscriber bases across providers, this segment is dominated by AMX (51.2% MS) and Sky (28.8% MS) which represent 80.8% of total pay TV subscribers. Nonetheless, smaller providers, namely Oi (MS 6.7%) and GVT (4.5% MS), have been taking MS points from the largest players as they migrate their broadband subscribers to 3P. Vivo (3.9% MS), which has shown little momentum in pay TV until 2014 (CAGR 12.1% from 4Q08 to 4Q14) has followed the same strategy seen in Spain, partially subsidizing pay TV in 3P in order to improve consumer loyalty and retention. As a result there was a 20.4% YoY increase in pay TV accesses in 2014. Going forward we expect pay TV subscriptions to continue to increase as providers to continually to incentivize subscribers to move to 3P in order to reduce churn. For Vivo, we are assuming a ST negative impact on the OIBDA margin associated with the cost of TV content and equipment. Similar to what we have discussed in FT, we consider that FBB will be the main driver of 3P and thus, we expect pay TV, FT and FBB accesses to converge.

GVT allows Vivo to expand its FBB service outside of São Paulo

In August 2014, TEF agreed to buy GVT from Vivendi SA for Eur7.2bn[42]. From a strategic perspective, this acquisition allows the company offer 4P products outside of São Paulo, increasing its FBB presence to 17 federal states, which corresponds to 83.8% of the population. In terms of FBB MS, with the addition of 4.7m GVT accesses, Vivo jumps in front of Oi with 29.4% of total accesses. Furthermore, Vivo consolidates its front seat position in São Paulo, where it had been losing space to GVT. All in all, this acquisition gives a long-term growth potential as an integrated player, with the ability to cover 91.3% of the population in the mobile segment and 83.8% of the population in the wireline segment. Additionally, Vivo will also benefit from GVT's superior network[43], which, as we mentioned above, has been a leader in terms of YoY growth (CAGR 47.1% 4Q07-4Q14). Going forward, we expect Vivo's FBB subscriber base to reach 12.7m (7.6% CAGR 2015e-22e, excluding the effect of the integration of the 4.7m accesses from GVT) on the back growing demand for FBB and GVT's high-quality network (see *Chart 38*).

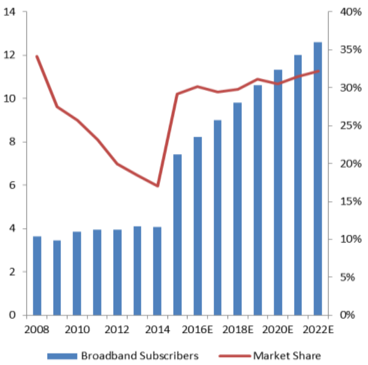

Chart 38 – Forecasted FBB accesses and market share, following the acquisition of GVT. (Source: Analyst Estimates.

[42] From the Eur7.2bn, Eur4.7 will be paid in cash, financed by a capital increase of Telefónica Brasil S.A. and through the rendering of Telefónica's 5.7% stake in Telecom Italia SpA over to Vivendi

[43] According to Anatel data, more than 86.0% of GVT's subscribers have broadband connection plans above 10 Mbps, 92% of which outside of São Paulo. In terms of average connection speed, GVT beats AMX in every state except Pernambuco and Goiás (14 out of 16). In São Paulo, the average connection speed was 19.3Mbps in January 2015, ahead of both Vivo (11.7 Mbps) and AMX (16.6Mbps)

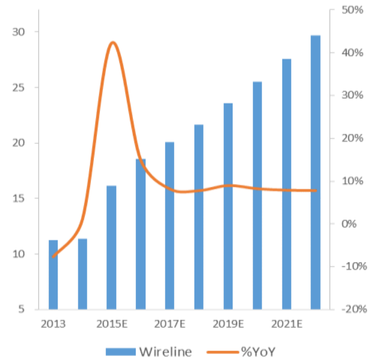

Chart 39 – Wireline Revenues forecast (m BRL) and expected YoY growth. (Source: Analyst Estimates.)

Positive outlook on the back on GVT's superior network

For Vivo's wireline business we forecast a top line CAGR of 13.2% from 2015e to 2022e (see *chart 39*), on the back of the incorporation of GVT into our estimates. From an operational standpoint we consider that GVT will have a short-term positive pressure on residential ARPU, due to the impact of its higher-end bundles. At the same time, we expect that Telefónica's push for 3P will also benefit ARPU, due to the additional revenue stream coming from pay TV. In terms of accesses, aside from the initial impact in 2015, we consider that GVT's superior network (as mentioned in the wireline segment) will allow Vivo to consolidate its position in São Paulo while benefiting from the sustained growth that GVT has shown at a country level. We recall that, between 1Q07 and 4Q14, GVT has increased its broadband market share by 9.6pp.

Consolidation in Brazil?

For quite some time now there has been significant speculation revolving further consolidation in Brazil, namely a possible tie-up between TIM and Oi or, a joint bid from Oi, Telefónica and América Móvil for TIM. The basic rationale behind the TIM+OI consolidation is that TIM is a mobile-only operator and Oi lacks the financial firepower to invest heavily in its mobile network (as we mentioned before, Oi has the lowest LTE coverage in Brasil). Together, Oi and TIM would reduce the much needed investment in mobile infrastructure and the resulting telecoms group would be able to shift some of this capex towards enhancing Oi's FBB network. However, we consider that it is still very unclear how this process will turn out due to Oi's current high leverage (4.2xEBITDA vs. the peer average of 2.4xEBTIDA) and due to major regulatory hurdles that the deal would face. In addition, we don't expect Telefónica to engage actively in further M&A activity in the short-term as the company stated that its focus was the closing and consequent integration of GVT, as well as keeping its leverage in check. For this reason we have not included any further consolidation scenarios in our valuation.

Valuation

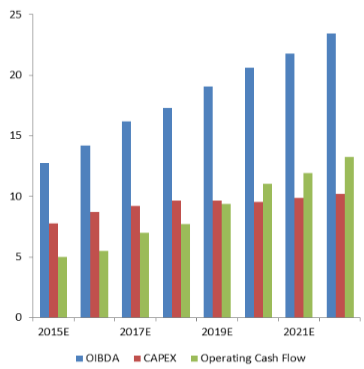

Chart 40 – Outlook for Vivo in terms of OIBDA, Capex and Operating Cash Flow in millions of BRL. (Source: Analyst Estimates)

Assuming a discount rate of 11.5% and growth in perpetuity of 2.8%, we value Telefónica Brasil at BRL72.9bn (Eur21.4bn). We have included the expected synergies coming from the incorporation of GVT in both OIBDA and capex. From 2015 to 2022, we expect OIBDA margin to suffer from costs associated with handset sales in the mobile segment, and TV content and equipment in the wireline unit. Moreover, we expect capex to remain relatively high in the medium-term as Vivo continues to expand its LTE coverage, deploy its FTTH network in São Paulo (4.2m houses passed in 1Q15) and integrates the expansion plans of GVT outside of this state (see *chart 40*).

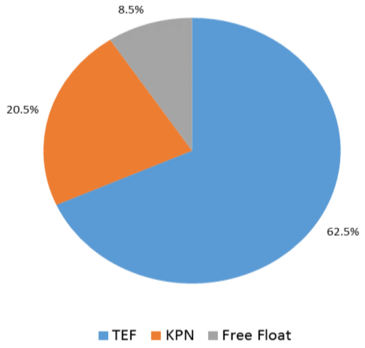

Chart 41 – Telefonica Deutschland's shareholder structure following the capital increase in 2014. Source: Bloomberg and analyst estimates)

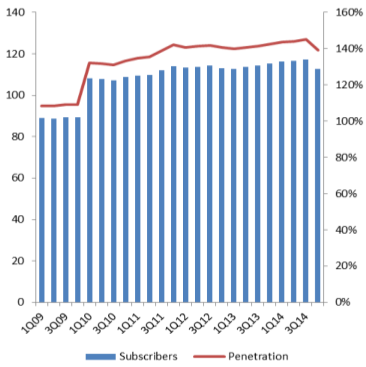

Chart 42 – Evolution of Mobile accesses (millions) and mobile penetration (accesses per 100 inhabitants) from 2009 to 2015. (Source: Company Data).

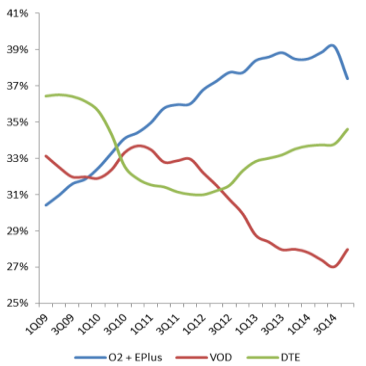

Chart 43 – Evolution of Mobile market share in terms of accesses from 1Q09 to 4Q14. (Source: Company Data).

Telefonica Deutschland

Since the divestment from the UK operation in 1Q15, T. Deutschland (O_2) is the only remaining subsidiary of the group operating in Europe, aside from Spain. In 2014, O_2 acquired E-Plus, KPN's German mobile arm, for Eur8.6bn with combination of Eur3.7bn in cash, finance through a rights issue, and a 20.5% stake in the enlarged company. Following the capital increase TEF's ownership was diluted from 76.8 to 62.5 (see *chart 41*). Moreover, O_2 (O2G GY) trades on the Frankfurt Stock Exchange with an estimated free float of 8.5%, which we value at Eur4.48 per share. Considering the dividend payments expected for the 2015e (Eur0.25/share), our valuation implies a negative shareholder return of 7.7% and thus, corresponds to a sell recommendation for investors. As we will try to demonstrate further below, our bearish stance regarding the O_2, is based on our expectation that, as we have seen in Spain, the telecom sector in Germany will progressively move towards convergence, leaving O_2, which has relatively low relevance in FBB (8.0% base MS), in a very uncomfortable position, comparing with its peers, namely DTE and VOD, who are already pushing aggressively for convergent tariffs.

Wireless Segment

Market overview - mature mobile market, with relatively high penetration

From 1Q09 to 4Q14, total mobile subscribers in Germany increased 5.3% (1.5% CAGR, see *chart 42*). In the meantime penetration has remained fairly stable at 139.1% (1.7% CAGR during this period). Comparing this level with other countries (124.6% in the UK and 109.1% in Spain) we expect penetration to remain fairly stable in the coming years as this is already a very mature mobile market.

O_2 becomes leader in subscribers with the integration of E-Plus

Following the acquisition of E-Plus, the mobile market in Germany is dominated by three MNOs – O_2[44] (42.1m subscribers and a MS 37.4%), DTE (39.0m/37.4%) and VOD (31.5m/28.0%). Since 1Q09, both O2 and E-Plus have been gaining momentum, increasing their MS at the expense of DTE and VOD (see *chart 43*). Between 1Q09 and 3Q14, TEF and E-Plus' MS increased 5.6 and 3.2pp respectively while DTE and VOD's declined 2.7 and 6.1pp.

O_2 as the cheaper alternative to Telekom and Vodafone

[44] TEF's merger with E-Plus lead to re-statement of the latter's mobile subscribers. Using data from 3Q14, and assuming no major subscriber losses in 4Q, TEF would have around 47.0m accesses in this quarter. However, TEF's assessment of its mobile base turned out to be more rigorous than E-Plus', with O2 reporting 42.1m accesses in 4Q14, which contributed heavily to the 2.3% YoY reduction of total mobile subscriptions seen in Germany.

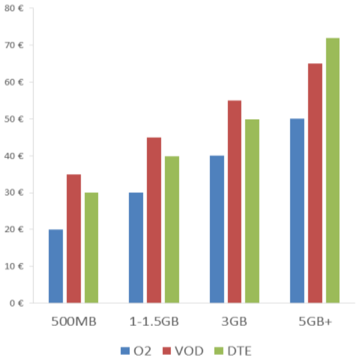

Chart 44 – Comparison of mobile contrast (post-paid) tariffs based on the data allowance included in each tariff. (Source: Company data).

In order to evaluate O_2's competitive positioning, we have compared four post-pay tariffs from DTE, VOD and TEF, based on the data allowance included. As we can see in *chart 44*, O_2 continues to be a considerably cheaper alternative to both VOD and DTE. For all four tariffs that we have compared, VOD is pricing its offers Eur15.0/month higher than O_2, whereas, DTE is pricing its *Magenta* tariffs Eur10.0/month higher than O_2 except for the 5GB (*Magenta L plus*) offer, which is Eur22/month more expensive than O_2's *Blue XL* 5GB bundle.

O_2 and E-Plus gain in subscriber MS pushes ARPU downwards

In our opinion, O_2's MS growth has been sustained by its cheaper tariffs at the expense of ARPU deterioration (*chart 45*). Between 2007 and 2014, O_2's ARPU shrunk 31.4% while E-Plus's revenue per user decreased 28.6%. At the same time, VOD and DTE strategy to protect its price points has result in lower ARPU destruction (-3.8% and -6.7%, respectively). Consequently, in terms of MSR, DTE remains the most profitable mobile operator with 36.4% of total service revenues, followed by VOD (31.7%) and O_2 (30.6%).

Chart 45 – Evolution of Mobile blended ARPU (MSR / subscriber / month) from 1Q09 to 4Q14 per operator. (Source: Analyst Estimates).

E-Plus integrations has negative pressure on ARPU

O_2's ARPU in 3Q14 was Eur12.7/month while E-Plus', whose revenue per user had been historically below O_2's, stood at Eur10.0/month. As expected, O_2's ARPU in 4Q14 decreased -9.9% YoY (1.6% QoQ), caused by the integration of E-Plus' pre-pay discount MVNOs such as Aldi Talk, Base or symio. Going forward, we expect that this ARPU destruction will be less severe as O_2 announced in 1Q15, that it will progressively discontinue most of E-Plus' brands.

ARPU Outlook – Strong data offsets lower voice revenues per user

From 2015e to 2022e, we expect that the ARPU in Germany to move in the same fashion as in Spain – strong growth in data, as O_2 pushes for data monetization (75% LTE coverage expected for 2015e and 90% for 2016e) and decreasing voice ARPU to a combination of flat MOU and deteriorating ARPM. Regarding data, we consider that there is a significant room for data monetization, since data usage per subscriber is still relatively low at 333 MB per month (vs. c.500 in Spain and c.440 in the UK) due to low smartphone penetration at 49.8% (vs. 62.8% in Spain) and low LTE penetration at 12.3% (vs. 13.7% in Spain and 22.4% in the UK). Hence, we assume a positive 3.1% CAGR for the data ARPU (see *chart 46*) on the back of higher levels of data traffic.

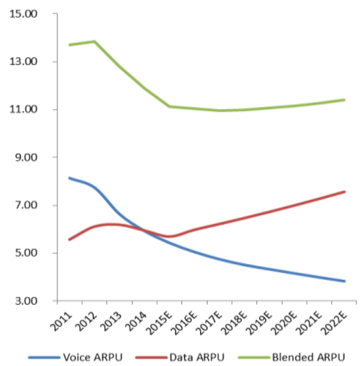

Chart 46 – Outlook for blended ARPU (MSR / subscriber / month), data and voice for Telefónica. Estimates start on 2015e.

In terms of voice revenues, voice ARPU has shrunk 27.2% between 2011 and 2014 due to a negative effect of O_2's pricing strategy on the ARPM (30.6% cut over the same period) at the same time that MOU remained fairly stable at 131.4 (0.7 CAGR over the same period). Going forward, we are assuming further negative pressure on ARPM due to the possibility of further cuts in the MTR, which has remained relatively high in this country (Eur0.0179/month vs. EU average of Eur0.0123/month). In 1Q15, the German regulator (BundesNetzAgentur) proposed to cut the MTR to 0.0172 by the end of 2015 and to Eur0.0166/min in 2016 (3.6% cut), which the EU Commission considers to be insufficient, arguing that it is c.80% higher than the rates in the majority of EU countries. Hence, we are assuming a 28.3% cut in the MTR, which implies that the German MTR will adjust to the current EU average of Eur0.0123/min in the long run. Considering that MOU will continue to remain relatively flat, we expect the voice ARPU will suffer an average YoY reduction of 5.3% between 2015e and 2022e and that the blended ARPU will stay flat (-0.5% CAGR) due to the positive contribution coming from data (see *chart 46*).

Improvements expected for O_2's poor mobile connectivity

O_2's mobile coverage has faced significant criticism over the last years due to its poor connectivity, especially in rural areas. For LTE network, O_2' maximum data rate is 50Mbit/s, less than two-thirds of what we have seen for DTE and VOD. For inner-cities this connectivity is considered to be sufficient, but O_2's data availability problem arises when costumers leave inner-city surroundings, where data transfers rarely occur over LTE. With the acquisition of E-Plus and subsequent merger of its UMTS networks TEF's promises to increase its coverage in rural areas. Going forward, aside from improving its commercial offer by marketing its enhanced network capabilities, we consider that the improved connectivity will lead to a reduction in churn, which has remained high for TEF in Germany (2.4% vs. 0.9% in Spain and 1.7% in the UK).

Convergence as a threat for Telefónica

Nonetheless, in the medium term, we consider that O_2's low relevance in FBB (MS of 7.4% in 4Q14), creates a strong risk for TEF in Germany since both DTE and VOD have been pushing for convergence. DTE, apart from being the second mobile MNO in terms of subscribers, is also the largest FBB provider in Germany, with 12.4m subscribers (41.3% MS). Since it first launched its convergent *MagentaEINS* tariff last year, DTE already added 906 thousand customers, which corresponds to 7.3% of its FBB base. VOD consolidated its position as an integrated player in 2014 with the Eur7.7bn acquisition of Kabel Deutschland, which increased its FBB subscriber MS from 9.8 to 17.9%. Since then VOD has added 255 thousand customers to its *All-In-One* convergent tariff, which corresponds to 4.2% of its FBB customers. Going forward we expect this operators to continue add customers to its convergent tariffs, either by upselling their DSL customers or by downshifting their mobile and DSL customers who would save on average Eur10.0/month on their bills. Furthermore, O_2 has positioned itself has a convergent player in other markets, with the commercial push in Spain with *Movistar Fusión* and with the acquisition of GVT in Brazil, while divesting in markets where the company lacked FBB infrastructure, for instance O_2 in the UK. In our opinion, following the acquisition of E-Plus, we do not expect TEF to exit the Germany market and thus we believe that sooner or later O_2 will have to make a strong commercial push for FBB, in order to increase its relevance as a fixed-to-mobile operator. Nevertheless, TEF has not mentioned any intention of expanding its wireline services nor has shown any interest in further M&A, and thus, we are not including those scenarios in our base case valuation model.

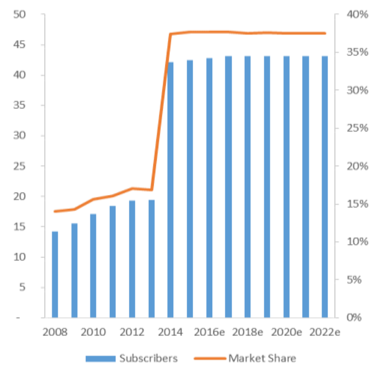

Chart 47 – Outlook for O_2's subscriber base and market share. Estimates start on 2015e. (Source: Analyst Estimates)

Stable MS on the back of retention strategy with concerns over LT strategy

Following the merger of E-Plus, we expect that, in the medium term (2015e-17e), O_2 will sustain its MS (Subscribers) at 37.7%, on the back competitive tariffs and network improvements (*chart 47*). We believe that O_2's handicap in terms of network coverage has not stopped this operator from increasing its MS in the past, and thus, we expect that the positive synergies coming from the combination its infrastructure with the one of E-Plus, will benefit the commercial portfolio. On the long-term (2018e-22e), however, considering the push for convergence from VOD and DTE, O_2's low relevance in FBB and the maturity of the German mobile market, we expect subscriber MS to fall to 37.5% with negative net additions starting on 2021e.

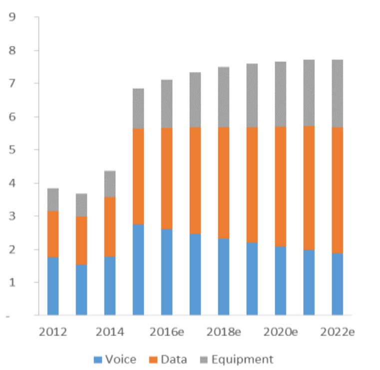

Chart 48 – Breakdown Wireless Business Revenues (m EUR), in terms of Voice, Data and Equipment for 2015e-22e. (Source: Analyst Estimates)

All in all, from 2015e to 2022e we expect O_2's mobile access to grow at a 1.6% CAGR with average net additions of 162 thousand per year (see *chart 41*). Considering our outlook for ARPU and subscribers, we forecast a CAGR for wireless business revenues at 1.7%, on the back of robust equipment (8.0% CAGR) and data revenues (4.0% CAGR) and negatively affected by voice revenues (-5.3% CAGR), as we can see in *Chart 48*.

Wireline Segment

As we have mentioned above, O_2 is predominantly a mobile operator - in 1Q15, O2's wireline revenues contributed solely 13.7% to total revenues. In terms of competition, O_2 is the fourth largest FBB provider, with only 7.4% of total accesses, behind DTE (42.3%), VOD (18.0%), 1und1 (12.8%) and Unitymedia (9.7%). Despite covering 90% of the country, consumer dissatisfaction is above competition, for the reason that most consumers experience connection speed below what is advertised and because of speed throttling for consumers with high traffic rates. Also, in contrast to what we have seen in mobile, O_2's *DSL All-in* portfolio does not offer significant discounts to its competitor (see *chart 49*).

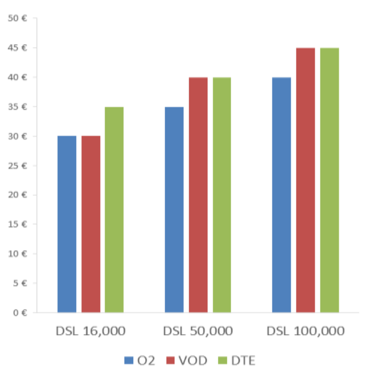

Chart 49 – 3P tariffs in Germany according to the FBB download speed. (Source: Company Data).

Furthermore, we have not seen any intention of TEF in improving is FBB infrastructure or make any significant moves in terms of prices or portfolio changes. Hence, we expect that O_2 will continue to lose momentum in this segment, and will continue to lose MS. From 2015e to 2022e we expect wireline accesses and revenues to fall at a CAGR of 4.2% and 6.6%, respectively.

Valuation

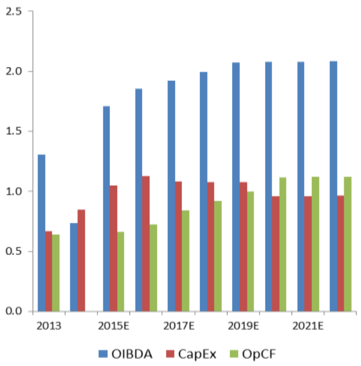

Chart 50 – OIBDA, Capex and Operating Cash Flow from 2015e-22e. (Source: Analyst Estimates)

Assuming a discount rate of 6.8% and a growth in perpetuity of 1.8%, we value O_2 Deutschland at Eur15.7bn, which corresponds to 7.5% of total group EV. We expect a poor top-line performance (CAGR 0.1%[45] adjusting for the integration of E-Plus for YoY comparisons) mostly due to the deteriorating wireline business (CAGR -6.6%) and to our concerns over the LT growth potential of the mobile unit. In terms of OIBDA, we assume that the margin will be pressured by O_2's monetization strategy, namely with smartphone equipment sales (8.0% CAGR), which are being subsided in order to increase smartphone penetration and, consequently, data traffic). Nonetheless, we consider that the integration of E-plus will result on a stronger margin (21.9% for 2015e and 23.0% for 2016e) due to the synergies created in terms of Opex[46]. In addition, we expect high levels of capex (Eur1.1bn for FY15e and 1.2bn for FY16e) due expansion of LTE coverage up to 90% by 2016e. There is also a positive contribution coming from the incorporation of E-plus, due to costs savings from implementing one LTE network. Regarding bottom-line, we expect CAGR of 8.6% from 2015e to 2022e, on the back of Opex and Capex synergies coming from the integration of E-plus. Nevertheless, between 2020e and 2022e, we are assuming slower bottom line growth (3.0% CAGR) as the effect of synergies worms off and due to the weaker top-line performance expected for the mobile unit during this period (*chart 50*).

Telefónica Hispanoamerica

Our valuation for T. HispAm is Eur24.6bn (25.8% of Group EV), which includes Argentina (2.9% of Group EV), Chile (4.9%), Peru (9.0%), Colombia (2.0%), México (3.9%), Venezuela and Central América[47] (0.7%), Ecuador (1.2%) and Uruguay (0.7%). For each subsidiary we have constructed a local currency DCF valuation, and used exchange rate spots to translate the calculated EV's to our SoP valuation. For the forecasted financials, we used forward exchange rates[48].

Robust growth in accesses on the back of developing economies

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45 Adjusted for the integration of E-Plus on 4Q14 in order to obtain meaningful YoY comparisons.
46 Reduction in personnel (1,600 FTEs by 2018), shop reduction (30%) and the decommission of 14,000 mobile sites.
47 Includes Guatemala, El Salvador, Panamá, Nicaragua and Costa Rica.
48 Obtained from Bloomberg.

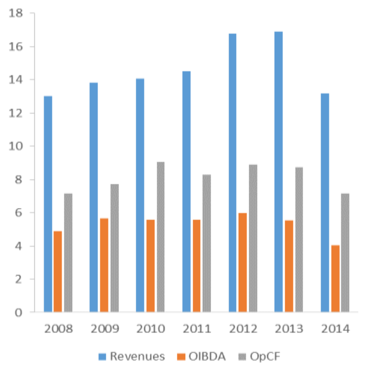

Chart 52 – HispAm Revenues, OIBDA and Op CF from 2008-14, in millions of Euros (Source: Analyst Estimates).

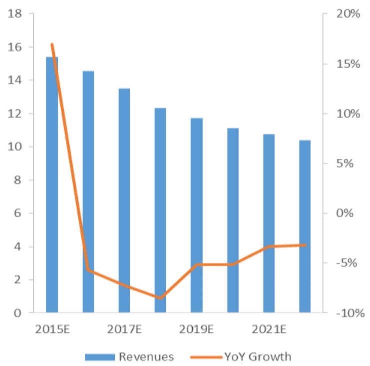

Chart 53 – Expected revenues (m EUR) and YoY Growth for HispAm from 2015e-22e. (Source: Analyst Estimates)

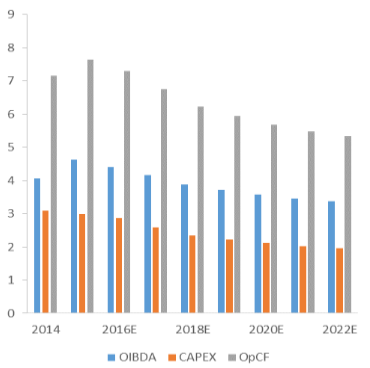

Chart 54 – Outlook for OIBDA, Capex and Operating Cash Flow for HispAm from 2015e-22e (Source: Analyst Estimates).

TEF has enjoyed consistent YoY growth in accesses in HispAm on the back of strong GDP growth (3.6% CAGR) and growing population (1.2% CAGR), pushing penetration rates upwards and across services. Going forward, we expect a gradual descent of subscriber growth, especially in mobile, since we already see penetration rates above 100% in Argentina, Chile, Colombia, Venezuela and Uruguay. In the wireline segment, we expect that the 3.5% average annual GDP growth expect for this countries, will continue to have a beneficial impact on the penetration of FBB, which has remained, on average, close 10.0% for this countries (the average in 2013 was 9.5%). All things considered, from 2015 to 2022, we expect subscriber CAGR of 1.2% for TEF HispAm.

Strong currency devaluation expected for in Argentina and Venezuela

TEF's operations in HispAm have helped to ease YoY revenue erosion seen in Spain. Between 2008 and 2013 (see *chart 52*), revenue CAGR (Euros) in HispAm was 5.5% (comparing with -9.0% in Spain), on the back of strong growth in Argentina (CAGR of 8.1% in Euros, 17.2% in Argentinian Pesos), Perú (CAGR of 8.8%, 4.1% in Peruvian Nuevo Sol), Venezuela (CAGR 7.6%, 22.7% in Bolivar) and Chile (CAGR 5.5%, 2.6% in Chilean Pesos). Accordingly, the contribution of HispAm operations to group revenues increased 7.1 pp to 29.6%, during the same period. However, in 2014, strong hyperinflation in Argentina and, especially, in Venezuela, led to a YoY 22.0% contraction in HispAm revenues (with weight in group revenues shrinking to 26.2%). In our forecasted financial statements, we have included forward exchange rates and took into consideration the hyperinflation seen in these countries. For Venezuela, we forecast a top-line CAGR of 32.4% in Bolivar and -18.5% in Euros, assuming further devaluations of Bolivar[49]. Similarly, in Argentina, we expect a revenue CAGR of 9.6% in Argentina Pesos and a -11.3% in Euros, taking into consideration the forward curve of EURARS pair. Nonetheless, we expect positive revenue growth coming from Perú (CAGR of 3.9% in PEN and 0.8% in EUR), Colombia (CAGR of 5.4% in COP and 1.1% in EUR) and from México (CAGR of 3.5% in MXN and 0.8% in EUR).

Bottom line affected by investment on LTE and FBB infrastructure

According to the 4Q14 results report, TEF plans to continue its strong investment seen in 2014 (Eur2.8bn of Capex ex-spectrum 29.1% organic increase YoY) focused on the deployment of LTE and FBB network. Hence, for 2015e-22e we expect capex to remain high (Eur3.0bn in 2015e and Eur2.9bn in 2016e) in the medium term, in line with what we have seen in 2014, with a gradual reduction to Eur2.0bn down the road (see *chart 54*).

[49] Since the bolivar is pegged to the dollar, we assumed currency devaluation in line with the expected inflation.

Valuation Metrics

Assumptions

For each of the 11 subsidiaries valuated using a local-currency DCF methodology, we applied different discount rates, as we can see in *table 6* below. For the risk-free rate we used a 2-year average of the 10-year German Bunds and then adjusted this value for each country using the expected inflation[50] differential. Regarding Beta, we used 2-year weekly data of TEF price returns against the MSCI World Index. Moreover, the cost of debt was obtained by analysing the historical interest expense both at the Group level and at its German and Brazilian subsidiaries. The target leverage of the Group was set according to company guidance, following the sale of O_2 UK[51] in 1Q15. Finally, the terminal growth for the was set according to the return on invested capital, the expected dividend payout and taking into consideration the expected GDP growth for each region as well as the penetration levels in each country.

Sensitivity Analysis

Furthermore, in order to test the robustness of our model, we developed a sensitive analysis for TEF, Vivo and O_2 Germany. For TEF, since we have 11 sets of WACC's and growth as inputs, we built our data table using the company levered beta and the target Debt-to-EV used to calculate the individual WACC's. As we can see in *table 7* (Appendix), since the downside of our current Eur11.7/share valuation is only 3.4%, our sell recommendation is quite sensitive to changes in this inputs. However, our recommendation would only change to buy for extreme input values (i.e. beta below 1 and D/EV above 45%). Regarding Vivo, we have constructed a sensitivity analysis in regards to the WACC and the growth in perpetuity used in the DCF model (*see table 8 in Appendix*). We conclude that, although our recommendation is highly sensitive to the chosen growth, we consider that this is a very key input for this region since Vivo's success in expanding its FBB business and migrating its mobile prepay subscribers to post-paid tariffs is highly correlated to the expected economic development of Brazil. Finally, concerning O_2 (*table 9 in Appendix*) we are quite confident about our sell recommendation (7.7% downside) as only extremely optimistic forecasts regarding the growth in perpetuity combined with a lower WACC would make our current target price (Eur4.5/share) higher than the current market price (Eur5.2/share).

[50] Inflation forecasts from IMF.

[51] According to a press release relating to the sale of O2 UK, the target Net Debt is 2.35xOIBDA. Since TEF our estimate for Net debt is different to what is reported from TEF, our target net debt was set at 3.4xOIBDA.

Scenario Analysis

	Bear		Base		Bull	
TEF	10.6	SELL	11.9	SELL	13.9	HOLD
Vivo	30.6	SELL	41.9	BUY	51.1	BUY
O_2	3.4	SELL	4.5	SELL	5.4	HOLD

Table 8 – Target Price and correspondent recommendation for the TEF, Vivo and O_2 under each of the alternative scenarios constructed.

In order to test the main forecasts of our model, we have developed two additional possible scenarios for Spain, Brazil and Germany (74.2% of Group EV), whose main assumptions are shown in *table 10 (Appendix)*. As we can see in *table 11,* not even our Bull scenario would be enough a buy recommendation for investors as the total expected return for investor would be 10.3%. For O_2, we concluded that, even in a scenario where O_2 increases its market share to 42.0% by 2022e as the German telecoms market doesn't move towards convergence in the medium-term, there insufficient upside potential for a buy recommendation for investors. Regarding Vivo, our alternative scenarios are based on the general development of the Brazilian economic, which we consider to have two important effects for TEF: (1) in mobile, we expect that a positive GDP growth (average 2.2% for 2016e-22e) will lead to a higher demand for contract subscriptions, which is Vivo's focus in this segment; and (2) in the wireline segment, the positive economic backdrop will support the demand for FBB at a country level. In conclusion, we are comfortable regarding our forecasts for these three segments.

Comparables

Looking TEF's comparables (*table 11*), we conclude the company underperformed its peers (11.8% 1-Year return vs. 17.6% peer average) and continues to be relatively levered (3.5xEBITDA vs 2.4x), a situation which we expect to be improved to 3.2xEBITDA in 2016e, with the divestment from O_2 UK.

Appendix

	Inflation	Risk-Free	MRP	Beta	Re	Rd	D / EV	Tax	WACC
Spain	1.1%	3.0%	6.00%	1.09	9.5%	4.5%	40.0%	25.0%	7.1%
Brazil	5.2%	6.2%	6.00%	1.09	12.7%	7.8%	15.0%	29.7%	11.6%
Germany	0.2%	1.2%	6.00%	1.09	7.8%	1.7%	15.0%	29.7%	6.8%
Argentina	20.1%	21.2%	6.00%	1.09	27.7%	4.5%	40.0%	35.0%	17.8%
Chile	3.0%	4.0%	6.00%	1.09	10.6%	4.5%	40.0%	22.5%	7.7%
Peru	2.1%	3.1%	6.00%	1.09	9.6%	4.5%	40.0%	30.0%	7.0%
Colombia	3.2%	4.2%	6.00%	1.09	10.7%	4.5%	40.0%	25.0%	7.8%
México	3.2%	4.3%	6.00%	1.09	10.8%	4.5%	40.0%	30.0%	7.7%
Venezuela	45.0%	46.0%	6.00%	1.09	52.6%	4.5%	40.0%	34.0%	32.7%
Ecuador	3.8%	4.8%	6.00%	1.09	11.3%	4.5%	40.0%	22.0%	8.2%
Uruguay	6.7%	7.7%	6.00%	1.09	14.2%	4.5%	40.0%	25.0%	9.9%

Table 6 – Main valuation assumptions used in our SOTP valuation.

	0.89	0.94	0.99	1.04	1.09	1.14	1.19	1.24	1.29
32%	13.6	12.8	12.0	11.3	10.6	10.0	9.4	8.9	8.4
34%	13.9	13.1	12.3	11.6	10.9	10.3	9.7	9.2	8.7
36%	14.3	13.4	12.6	11.9	11.2	10.6	10.0	9.5	9.0
38%	14.6	13.8	13.0	12.2	11.6	10.9	10.3	9.8	9.3
40%	15.0	14.1	13.3	12.6	**11.9**	11.3	10.7	10.1	9.6
42%	15.4	14.5	13.7	13.0	12.3	11.6	11.0	10.4	9.9
44%	15.8	14.9	14.1	13.3	12.6	12.0	11.4	10.8	10.3
46%	16.2	15.4	14.5	13.8	13.0	12.4	11.8	11.2	10.6
48%	16.7	15.8	15.0	14.2	13.5	12.8	12.2	11.6	11.0

Table 7 – Sensitivity analysis for the target price of TEF (Group) in terms of target capital structure (column variable) and the company's levered Beta (row variable).

	2.4%	2.5%	2.6%	2.7%	2.8%	2.9%	3.0%	3.1%	3.2%
10.8%	52.7	54.1	55.5	56.9	58.3	59.8	61.3	62.9	64.5
11.0%	48.6	49.9	51.2	52.6	53.9	55.3	56.8	58.2	59.7
11.2%	44.7	45.9	47.2	48.4	49.7	51.1	52.4	53.8	55.2
11.4%	41.0	42.2	43.3	44.5	45.7	47.0	48.3	49.6	50.9
11.6%	37.5	38.5	39.6	40.8	**41.9**	43.1	44.3	45.6	46.8
11.8%	34.1	35.1	36.1	37.2	38.3	39.4	40.6	41.7	42.9
12.0%	30.8	31.8	32.8	33.8	34.8	35.9	37.0	38.1	39.2
12.2%	27.7	28.6	29.5	30.5	31.5	32.5	33.5	34.6	35.6
12.4%	24.7	25.6	26.5	27.4	28.3	29.3	30.2	31.2	32.2

Table 8 – Sensitivity analysis for the target price of Vivo in terms of WACC (column variable) and Growth in Perpetuity (row variable).

	Bear Case	Base Case	Bull Case
Spain	Consumers are very sensitive to the price differential. In FBB, Orange and Vodafone increase their FTTH coverage and TEF loses market share. In the mobile segment, a higher than expected MS erosion, as consumers opt for cheaper tariffs offered by the competition.	Market Share erosion in both segment due to less competitive mobile and 4P tariffs. However, in the wireline segment, positive net additions are expected due as penetration increase and TEF benefits from its wider FTTH coverage.	Consumers are insensitive to the price differential between TEF and its competition. We assume that Telefónica is able to sustain its market share in both segments
Brazil	Demand for Broadband is lower than expected, due to worse economic conditions. In the mobile segment, prepay continues to have a substantial relevance and thus, Telefónica loses MS.	Vivo deploys GVT's FBB network outside of São Paulo and gains FBB market share on the back of its high quality network and strong foothold in São Paulo. In Mobile, Vivo, despite positive net additions YoY, loses MS in the prepay segment.	The penetration of fixed broadband is higher than expected due to very high demand for this service, boosted by better than expected economic environment. On the mobile segment, Vivo gains market share as demand for contract increases due to better economic conditions.
Germany	Convergence is higher than expected as DTE and VOD's 4P offers gain significant tariffs. MS erosion in the long term is higher than expected as O2 customers who have wireline 3P services from DTE and VOD migrate to 4P in order to achieve cost savings.	O2 is able to sustain its mobile MS in the Short-term due to the network improvements. In the LT MS erosion is assumed as the convergent offers of DTE and VOD gain traction.	The 4P offers of DTE and VOD are insufficient for the market to shift towards convergence. O2 sustains its MS in the short-term and gains market share on the medium term due to its cheaper tariffs and network improvements.

Table 10 – Scenario Analysis for Spain, Brazil and Germany (Source: Analyst Estimates).

	Mkt Cap	Price	1-Yr Rtrn	P/E	EPS	EV / Sales	EV / EBITDA	Leverage
TEF	65,681	13.3	11.8%	22.6	0.88	2.6x	7.2x	3.5x
VOD	90,526	3.4	27.9%	11.1	0.28	n.a.	8.1x	n.a.
ORA	39,283	14.8	25.2%	36.8	0.35	n.a.	5.5x	n.a.
DTE	76,651	16.9	30.8%	40.6	0.42	2.1x	6.6x	2.9x
BT	54,126	6.5	15.1%	17.3	0.34	2.4x	6.8x	0.9x
TIT	20,559	1.1	23.9%	36.5	0.06	2.6x	5.9x	3.5x
KPN	14,515	3.4	23.5%	85.0	-0.05	n.a.	8.6x	n.a.
BELG	11,089	32.8	36.7%	16.6	1.98	2.0x	7.6x	1.0x
TLSN	24,134	5.6	6.6%	15.6	0.36	3.1x	7.9x	2.4x
SCMN	27,652	533.8	5.3%	17.2	27.56	3.2x	8.3x	1.8x
NOS	3,482	6.8	39.9%	55.0	0.12	3.3x	8.6x	2.3x
TEL	31,413	20.9	27.0%	25.0	0.85	2.7x	7.4x	1.3x
JAZ	3,321	12.9	20.5%	43.6	0.30	3.2x	14.1x	2.7x
OI	1,644	1.9	-64.6%	n.a.	-3.08	1.5x	6.2x	4.2x
AMX	61,991	0.9	33.7%	26.9	0.03	1.9x	6.0x	2.0x
Av.	**35,071**	**45.0**	**17.6%**	**32.1**	**2.03**	**2.5x**	**7.6x**	**2.4x**

Table 11 – Comps table as of May 21, 2015. (Source: Bloomberg)

Financial Statements

Telefónica S.A

Recommendation	**SELL**
Fair value	11.90
Current Share Price	13.30
Upside/Downside	-3.4%
Shares in issue	4,938
Market Capitalization	65,681
Free Float	82%

Valuation Metrics	2013	2014	2015e	2016e	2017e	2018e
EV / Revenue	1.86x	2.11x	2.25x	2.29x	2.37x	2.46x
EV / EBITDA	5.57x	6.85x	6.95x	6.99x	7.02x	7.17x
EV / Op FCF	11.3x	11.2x	12.6x	12.3x	13.1x	14.1x
EPS	0.99	0.61	0.80	0.66	0.67	0.73
P/E	12.02	19.51	14.80	18.02	17.76	16.34
DPS	0.75	0.75	0.75	0.75	0.75	0.75
Dividend Yield	6.30%	6.30%	6.30%	6.30%	6.30%	6.30%

Key Ratios	2013	2014	2015e	2016e	2017e	2018e
OIBDA Margin	33.40%	30.80%	32.44%	32.75%	33.81%	34.35%
EBIT Margin	16.56%	13.83%	14.14%	14.77%	16.79%	18.43%
Capex / Revenue	16.46%	18.75%	17.81%	18.62%	18.14%	17.42%
Capex / Depreciation	0.98x	1.11x	0.99x	1.04x	1.07x	1.09x
Net Debt / OIBDA	2.38x	2.91x	3.14x	2.65x	2.71x	2.83x
OIBDA / Net Interest	6.66x	5.50x	5.26x	6.27x	6.15x	5.93x
ROE	10.92%	12.33%	10.18%	10.47%	11.53%	11.80%
ROIC	5.55%	3.94%	4.63%	3.56%	4.08%	4.39%

P&L Summary	2013	2014	2015e	2016e	2017e	2018e
Revenues	**57,061**	**50,377**	**47,145**	**46,392**	**44,784**	**43,102**
YoY (%)	-8.49%	-11.71%	-6.42%	-1.60%	-3.47%	-3.76%
OIBDA	**19,077**	**15,515**	**15,294**	**15,192**	**15,141**	**14,806**
OIBDA Margin	33.40%	30.80%	32.44%	32.75%	33.81%	34.35%
YoY (%)	-10.15%	-18.67%	-1.43%	-0.66%	-0.34%	-2.21%
Depreciations	-9,627	-8,548	-8,630	-8,339	-7,623	-6,861
EBIT	**9,450**	**6,967**	**6,664**	**6,853**	**7,518**	**7,945**
Associates	-304	-510	-386	-386	-386	-386
Net financial costs	-2,866	-2,822	-2,906	-2,421	-2,461	-2,496
EBT	**6,280**	**3,635**	**3,372**	**4,046**	**4,671**	**5,064**
Income taxes	-1,311	-383	-944	-1,012	-1,168	-1,266
EBM	**4,969**	**3,252**	**4,046**	**3,035**	**3,504**	**3,798**
Non-controlling interests	-376	-251	-312	32	-392	-416
Net income	**4,593**	**3,001**	**3,734**	**3,067**	**3,112**	**3,382**
EPS	0.99	0.61	0.80	0.66	0.67	0.73

Balance Sheet Summary	2013	2014	2015e	2016e	2017e	2018e
Non-Current assets	**89,597**	**99,435**	**93,879**	**94,179**	**94,680**	**95,327**
Intangible assets	18,548	22,353	19,161	19,161	19,161	19,161
Goodwill	23,434	25,111	19,626	19,626	19,626	19,626
PPE	31,040	33,343	33,112	33,412	33,913	34,560
Other Assets	16,575	18,628	21,980	21,980	21,980	21,980
Current assets	**29,265**	**22,864**	**35,770**	**19,809**	**19,224**	**18,612**
Inventories	985	934	874	860	830	799
Trade Receivables	9,640	10,606	9,926	9,767	9,429	9,075
ST Financial Assets	2,117	2,932	2,932	2,932	2,932	2,932
Tax receivables	1,664	1,749	1,637	1,610	1,555	1,496
Cash & Equivalents	9,977	6,529	6,085	4,639	4,478	4,310
Other Assets	4,882	114	14,316	0	0	0
Total Assets	**118,862**	**122,299**	**129,648**	**113,988**	**113,904**	**113,939**
Shareholder's Equity	21,185	21,115	21,365	20,949	20,577	20,475
Non-controlling interests	6,297	9,174	8,760	8,760	8,760	8,760
LT Financial Debt	51,172	50,688	48,753	48,753	48,753	48,753
ST Financial Debt	9,527	9,094	16,276	5,432	6,326	7,096
ST Payables	15,221	16,943	15,856	15,603	15,062	14,496
Other Liabilities	15,460	15,285	18,638	14,491	14,427	14,359
Total Equity and Liabilitie	**118,862**	**122,299**	**129,648**	**113,988**	**113,904**	**113,939**

Cash Flow Summary	2013	2014	2015e	2016e	2017e	2018e
EBIT	9,450	6,967	6,664	6,853	7,518	7,945
Notional Income Taxes	-2,835	-2,090	-1,866	-1,713	-1,880	-1,986
Tax Adjustments	573	708	0	0	0	0
NOPLAT	7,188	5,584	4,798	5,140	5,639	5,959
Depreciations	9,627	8,548	8,630	8,339	7,623	6,861
Gross FCF From Operations	**16,815**	**14,132**	**13,428**	**13,479**	**13,262**	**12,820**
Intangible assets	3,530	-3,805	3,192	0	0	0
Goodwill	4,529	-1,678	5,485	0	0	0
PPE	3,981	-2,302	231	-2,787	-3,222	-3,817
Inventories	203	51	60	143	173	204
Trade and other receivables	1,071	-966	680	-747	-409	-55
LT Trade & Other Payables	-440	676	-58	0	0	0
ST Payables	-1,867	1,722	-1,087	2,408	1,867	1,301
FCF From Operations	18,041	-980	13,284	6,364	6,246	5,782
Non-Operating Activities	-4,353	1,684	-12,673	9,911	9,911	9,911
Free Cash Flow to the Firm	**13,688**	**704**	**611**	**16,274**	**16,157**	**15,692**
Net financial income	-2,866	-2,822	-2,906	-2,421	-2,461	-2,496
Tax Shield	860	847	814	605	615	624
Cash Change in Debt	-6,530	1,717	5,691	-8,463	-7,001	-5,999
Cash Change in Equity	-5,148	-445	-4,210	-5,996	-5,599	-6,630
CF from Financing Activities	**-13,684**	**-704**	**-611**	**-16,275**	**-14,446**	**-14,501**

T. Spain	2013	2014	2015e	2016e	2017e	2018e
Revenues	**12,959**	**12,023**	**11,666**	**11,430**	**11,239**	**11,159**
YoY (%)	-13.5%	-7.2%	-3.0%	-2.0%	-1.7%	-0.7%
Wireless	5,121	4,556	4,178	3,920	3,702	3,541
YoY (%)	-20.6%	-11.0%	-8.3%	-6.2%	-5.6%	-4.4%
Wireline	8,861	8,543	8,518	8,504	8,515	8,588
YoY (%)	-7.1%	-3.6%	-0.3%	-0.2%	0.1%	0.9%
OIBDA	**6,340**	**5,671**	**5,193**	**5,098**	**5,046**	**5,021**
YoY (%)	0.0%	-10.6%	-8.4%	-1.8%	-1.0%	-0.5%
OIBDA Margin	48.9%	47.2%	44.5%	44.6%	44.9%	45.0%
Capex	1,529	1,732	2,172	2,286	2,135	1,897
% of Revenues	11.8%	14.4%	18.6%	20.0%	19.0%	17.0%
Op CF	**4,811**	**3,939**	**3,021**	**2,812**	**2,911**	**3,124**
YoY (%)	0.0%	-18.1%	-23.3%	-6.9%	3.5%	7.3%

T. Brazil	2013	2014	2015e	2016e	2017e	2018e
Revenues	**33,326**	**35,318**	**42,018**	**45,888**	**48,660**	**51,317**
%YoY	1.2%	6.0%	19.0%	9.2%	6.0%	5.5%
Wireless	22,082	23,949	25,845	27,306	28,561	29,654
%YoY	6.5%	8.5%	7.9%	5.7%	4.6%	3.8%
Wireline	11,247	11,366	16,169	18,582	20,099	21,663
%YoY	-7.7%	1.1%	42.3%	14.9%	8.2%	7.8%
OIBDA	**10,756**	**11,139**	**12,611**	**14,225**	**16,301**	**17,448**
%YoY	-14.0%	3.6%	13.2%	12.8%	14.6%	7.0%
OIBDA Margin	32.3%	31.5%	30.0%	31.0%	33.5%	34.0%
Capex	5,873	9,180	7,325	8,719	9,245	9,699
% of Revenues	17.6%	26.0%	17.4%	19.0%	19.0%	18.9%
Op CF	**4,883**	**1,959**	**5,286**	**5,507**	**7,056**	**7,749**
%YoY	-25.4%	-59.9%	169.8%	4.2%	28.1%	9.8%

T. Deutschland	2013	2014	2015e	2016e	2017e	2018e
Revenues	**4,914**	**5,522**	**7,913**	**8,111**	**8,271**	**8,378**
%YoY	-5.7%	12.4%	43.3%	2.5%	2.0%	1.3%
Wireless	3,673	4,375	6,859	7,120	7,343	7,510
%YoY	-4.5%	19.1%	56.8%	3.8%	3.1%	2.3%
Wireline	1,235	1,138	1,053	991	928	868
%YoY	-9.4%	-7.9%	-7.4%	-5.9%	-6.4%	-6.5%
OIBDA	**1,308**	**733**	**1,729**	**1,866**	**1,985**	**2,095**
%YoY	-3.2%	-44.0%	135.9%	7.9%	6.4%	5.5%
OIBDA Margin	26.6%	13.3%	21.8%	23.0%	24.0%	25.0%
CapEx	666	849	1,062	1,136	1,158	1,139
% of Revenues	13.6%	15.4%	13.4%	14.0%	14.0%	13.6%
OpCF	**642**	**-116**	**667**	**730**	**827**	**955**
%YoY	-13.5%	-118%	-675%	9.4%	13.3%	15.5%

Disclosures and Disclaimer

Research Recommendations

Buy	Expected total return (including dividends) of more than 15% over a 12-month period.
Hold	Expected total return (including dividends) between 0% and 15% over a 12-month period.
Sell	Expected negative total return (including dividends) over a 12-month period.

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