

## Telefonica, S.A. (TEF)

**\$4.85** (As of 05/01/20)

Price Target (6-12 Months): **\$5.25**

Long Term: 6-12 Months

**Zacks Recommendation:**

**Neutral**

(Since: 10/30/19)

Prior Recommendation: Underperform

Short Term: 1-3 Months

**Zacks Rank:** (1-5)

**3-Hold**

Zacks Style Scores:

VGM:B

Value: A

Growth: C

Momentum: F

### Summary

Telefonica is capitalizing on the opportunities in the digital world through several growth strategies to enhance its long-term prospects, while experiencing increased traction in the smartphone market. It has accelerated the deployment of ultra-fast networks. Consistent rollout of fiber and LTE are set to drive growth. Telefonica's acquisition of GVT has put the company in a better position vis-à-vis stronger rivals like America Movil and Oi. However, domestic competition is a hurdle as unbundled local loop regulation is compelling the company to make its network available to alternative providers, resulting in wireline telephony access erosion. It faces intense competition in Brazil. Although it is striving to lower debts through sale of non-strategic assets and reduction of dividend payouts, high debt-laden balance sheet is a concern.

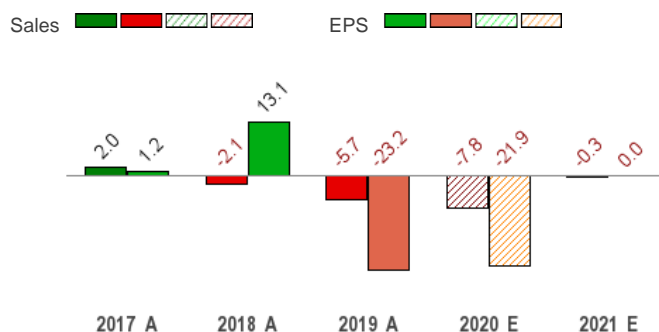
### Price, Consensus & Surprise



### Data Overview

52 Week High-Low	\$8.55 - \$3.75
20 Day Average Volume (sh)	1,189,452
Market Cap	\$25.2 B
YTD Price Change	-30.4%
Beta	0.80
Dividend / Div Yld	\$0.33 / 7.2%
Industry	<a href="#">Diversified Communication Services</a>
Zacks Industry Rank	Bottom 42% (148 out of 253)

### Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	NA
Last Sales Surprise	NA
EPS F1 Est- 4 week change	-8.1%
Expected Report Date	05/08/2020
Earnings ESP	0.0%
P/E TTM	6.5
P/E F1	8.5
PEG F1	1.4
P/S TTM	0.5

### Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021					49,844 E
2020					50,019 E
2019	13,604 A	13,645 A	13,233 A	13,734 A	54,239 A

### EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021					\$0.57 E
2020					\$0.57 E
2019	\$0.20 A	\$0.21 A	\$0.14 A	\$0.20 A	\$0.73 A

\*Quarterly figures may not add up to annual.

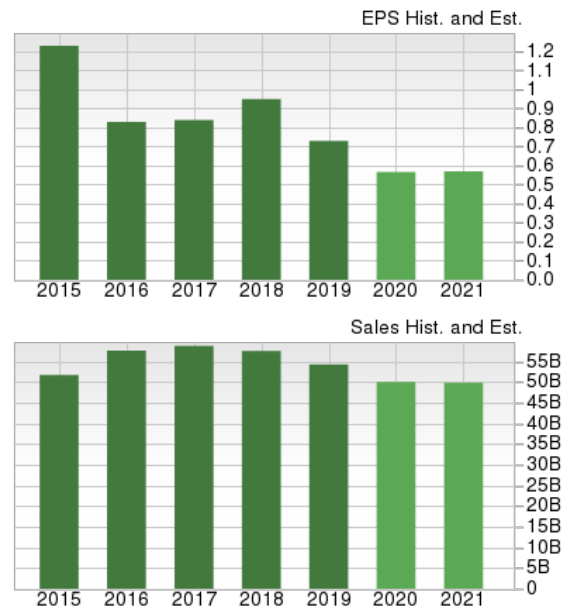
The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 05/01/2020. The reports text is as of 05/04/2020.

## Overview

Based in Madrid, Spain, Telefonica, S.A. provides fixed-line telephone services, wireless communications, Internet access, video and data transmission services, to approximately 313 million customers.

The business operations of the company are classified according to the geographic regions.

- **Telefonica Espana** (26.8% of total revenues in fourth-quarter 2019): The segment oversees the fixed and mobile telephone, broadband Internet, pay TV and value added services and data businesses in Spain (Espana).
- **Telefonica Deutschland** (16.2%): This segment offers fixed and mobile telephony services, broadband Internet, pay TV, data and value-added services in Germany.
- **Telefonica U.K.** (15.8%): This segment offers fixed and mobile telephony services, broadband Internet, pay TV, data and value-added services in the U.K.
- **Telefonica Brasil** (20.6%): This segment offers fixed and mobile telephony services, broadband Internet, pay TV, data and value-added services in Brazil.



During first-quarter 2018, Telefonica Hispanoamerica was split into two new units in order to more effectively manage the different market situations: Telefonica Hispam Sur and Telefonica Hispam Norte.

- **Telefonica Hispam Sur** (13.1%): This segment offers fixed and mobile telephony services, broadband Internet, pay TV, data and value-added services in Argentina, Chile, Peru and Uruguay.
- **Telefonica Hispam Norte** (7.5%): This segment offers fixed and mobile telephony services, broadband Internet, pay TV, data and value-added services in Colombia, Mexico, Central America, Ecuador and Venezuela.



---

## Reasons To Buy:

- ▲ Telefonica's acquisition of E-Plus has positioned it as the largest mobile service provider in Germany in terms of subscriber count. Moreover, the company has completed the acquisition of Vivendi's broadband assets – GVT. For Telefonica, synergies from the acquisition appear quite promising. The GVT deal has put Telefonica in a better position within the broadband segment vis-à-vis stronger rivals like America Movil and Oi. Additionally, GVT has expanded the company's broadband network to more than 10.4 million homes across 21 Brazilian states apart from strengthening its broadband customer base by an additional 2.5 million.
- ▲ Telefonica announced that it will be restructuring its Latin American business, while remaining focused in other key European markets and the United States. With a major upheaval in eight Latin American markets, the company aims to "reinvent" itself amid a challenging macroeconomic environment. The radical restructuring process is likely to feature an "operational spin-off", whereby the company will create two separate business entities, namely Telefonica Tech and Telefonica Infra. With the creation of the new units for digital technology and infrastructure assets, Telefonica expects to generate additional revenues of more than €2 billion a year by 2022.
- ▲ Telefonica is successfully capitalizing on the opportunities in the digital world through several growth strategies. Moreover, the company has significantly accelerated the deployment of ultrafast networks. Notably, it continues to witness increased traction in the smartphone arena. Continued rollout of fiber and LTE are set to drive considerable growth. Telefonica is augmenting its 5G network infrastructure in Spain by reinforcing long-term partnership with Huawei. In addition, the company will adopt a multi-vendor strategy by collaborating with another unnamed service provider to establish 5G infrastructure in 2020. Nokia and Ericsson are potential contenders to join the fray and team up with Telefonica in Spain.

Acquisition of E-Plus has enhanced Telefonica's position as the largest mobile service provider in terms of subscriber count in Germany.

---

## Reasons To Sell:

- ▼ The existence of critical suppliers in the supply chain, especially in areas such as network infrastructure, information systems or handsets with a high concentration in a small number of suppliers, poses risks which affect Telefonica's operations. Domestic competition poses a major hurdle as the unbundled local loop (ULL) regulation is compelling Telefonica to make its network available to alternative providers. The ULL regulation coupled with increased exposure to direct access competitors continue to be primary factors behind the company's wireline telephony access erosion.
- ▼ The Telefonica Group operates in highly competitive markets and it is possible that the Group may not be able to market its products and services effectively or respond successfully to the different commercial actions carried out by its competitors. The Group may also fail to meet its growth plans or to retain its customers. Moreover, the Telefonica Group is exposed to risks in relation to compliance with anti-corruption laws and regulations and economic sanctions programs. Telefonica faces increased competition in Brazil, the largest contributor to its Latin American revenues, which has contracted bottom-line growth.
- ▼ Telefonica has a debt-laden balance sheet. As of Dec 31, 2019, the company had cash and cash equivalents of €6,042 million with non-current financial liabilities of €43,288 million. Accumulating debt may pose problem for its credit ratings going ahead, although the company is striving to bring down debts through modified financial strategies such as vending of non-strategic assets on an opportunistic basis and reduction of dividend payments. Markedly, the company also looks relatively more leveraged than the sub-industry. Its debt/capital ratio is currently pegged at 0.70 compared with 0.64 recorded by the sub-industry. It is likely that a highly leveraged balance sheet can inflate the company's financial obligations and hurt profitability. Although the times interest earned ratio of Telefonica and its sub-industry increased sequentially to 2 and 1.9 respectively, the dividend payout rate of the company is 45% which is lower compared with 58.2% of the sub-industry. This indicates that the company is sharing less of its earnings with stockholders compared with the sub-industry. Moreover, its cash ratio is unfavorable which means that Telefonica is likely to encounter financial difficulties in the near future.

Competitive domestic and Latin American markets together with a debt-laden balance sheet act as near-term risks for Telefonica.

## Last Earnings Report

### Telefonica Incurs Loss in Q4, Revenues Decline Y/Y

Telefonica reported unimpressive fourth-quarter 2019 results, with the top line declining on a year-over-year basis.

#### Net Loss

In the December quarter, the Spanish telecom giant's net loss was €202 million or a loss of €0.05 per share (\$223.6 million or 6 cents per share) against net income of €610 million or €0.11 per share in the year-ago quarter. In 2019, net income plunged 65.7% year over year to €1,142 million or €0.17 per share. On an adjusted basis, fourth-quarter net income per share came in at €0.18 (20 cents).

#### Revenues

Quarterly aggregate revenues declined 4% year over year to €12,400 million (\$13,728.3 million) due to changes in the perimeter and the effect of currency depreciation. However, organic revenues moved up 2% year over year on the back of sustained service revenue growth and handset sales. In 2019, revenues inched down 0.6% year over year to €48,422 million.

#### Quarterly Results by Business Units

**Telefonica Espana:** Revenues in Spain inched up 0.4% year over year on a reported basis to €3,266 million (\$3,615.9 million), driven by service revenue growth. OIBDA margin was 41.9% compared with 29.7% in the year-ago quarter, which reflects improved operating expenses.

**Telefonica Deutschland:** Revenues climbed 0.2% to €1,970 million (\$2,181 million) backed by the performance of the O2 Free portfolio, further easing of legacy base headwinds partly offset by ongoing regulatory impacts and a slight decline in handset sales. OIBDA margin was 31.9% compared with 24.5% in the year-ago quarter, supported by contribution from improved efficiencies.

**Telefonica UK:** Revenues increased 4.3% year over year to €1,925 million (\$2,131.2 million). This was driven by higher value handset revenues and consistent growth in Smart Metering Implementation Programme (SMIP) as well as MVNO revenues. OIBDA margin was 27% compared with 28.3% in the year-ago quarter, reflecting higher ALFs and adverse year-over-year comparisons.

**Telefonica Brasil:** Revenues in Brazil declined 2.1% to €2,499 million (\$2,131.2 million) primarily due to the decline in voice and DTH, as a result of greater focus on IPTV. OIBDA margin increased to 45.7% from 38.4% owing to a €29 million positive impact from related to the adequacy of international intellectual property.

**Telefonica Hispam Sur:** Revenues in this segment declined 19.5% to €1,599 million (\$1,770.3 million) mainly due to negative regulatory impacts in Chile and Peru. OIBDA margin declined to 8.2% from 24.3%.

**Telefonica Hispam Norte:** Revenues in the segment fell 11.7% year over year to €916 million (\$1,014.1 million), affected by Ecuador's macro-economic environment in spite of growth acceleration in Mexico and the return to positive growth in Colombia. OIBDA margin declined to 3.4% from 4.4%.

#### Other Details

Overall, OIBDA (operating income before depreciation and amortization) came in at €3,669 million, up 3.8% year over year. The upside can be attributed to the impact of IFRS 16 accounting standard. OIBDA margin was 29.6% compared with 27.4% in the year-ago quarter. Operating income was down 14.4% to €914 million.

#### Cash Flow & Liquidity

In 2019, Telefonica generated €15,022 million of net cash from operating activities compared with €13,423 million in 2018. As of Dec 31, 2019, the company had €6,042 million (\$6,775.9 million) in cash and equivalents with €43,288 million (\$48,546.3 million) of non-current financial liabilities compared with the respective tallies of €5,692 million and €45,334 million a year ago.

*Conversion rate used:*

€1 = \$1.107119 (period average from Oct 1, 2019 to Dec 31, 2019)

€1 = \$1.121473 (as of Dec 31, 2019)

Quarter Ending 12/2019

Report Date	Feb 20, 2020
Sales Surprise	NA
EPS Surprise	NA
Quarterly EPS	0.20
Annual EPS (TTM)	0.75

## Recent News

On May 4, 2020, per Reuters, Telefonica Brasil announced that its British telecommunications subsidiary — O2 — will be merging with yet another UK-based telecom giant — Virgin Media. Talks between the two companies are in early stage. Markedly, the deal is expected to revamp Britain's telecom industry and reduce Telefonica's massive debt load, thereby raising the pressure on BT Group. However, financial terms of the deal have not yet been disclosed.

On Mar 10, 2020, per Reuters, Telefonica Brasil and TIM have expressed interest in negotiating a joint offer to buy the mobile unit of bankrupt Brazil-based carrier — Oi. The companies informed Oi's financial advisor of their interest in starting negotiations for a potential acquisition of all or part of its mobile division. If their bid is successful, the two companies will divide Oi's mobile business.

## Valuation

Telefonica shares are down 40.6% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Utilities sector are down 43.1% and 21.3% over the past year, respectively.

The S&P 500 Index is down 3.8% in the past year.

The stock is currently trading at 0.88X trailing 12-month book value, which compares to 2.3X for the Zacks sub-industry, 3.03X for the Zacks sector and 3.75X for the S&P 500 Index.

Over the past five years, the stock has traded as high as 2.06X and as low as 0.75X, with a 5-year median of 1.59X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$5.25 price target reflects 5.97X trailing 12-month book value.

The table below shows summary valuation data for TEF

Valuation Multiples - TEF					
		Stock	Sub-Industry	Sector	S&P 500
P/B TTM	Current	0.88	2.3	3.03	3.75
	5-Year High	2.06	4.66	4.05	4.55
	5-Year Low	0.75	1.75	2.01	2.84
	5-Year Median	1.59	2.36	2.6	3.64
P/E F12M	Current	8.54	10.55	11.73	20.18
	5-Year High	20.46	17.57	15.32	20.18
	5-Year Low	6.22	9.93	11.35	15.19
	5-Year Median	10.92	15.16	13.79	17.44
P/S F12M	Current	0.5	1.17	2.5	3.19
	5-Year High	1.4	3.93	3.29	3.44
	5-Year Low	0.41	1.14	1.75	2.54
	5-Year Median	0.83	1.3	2.04	3.01

As of 05/01/2020

## Industry Analysis Zacks Industry Rank: Bottom 42% (148 out of 253)



## Top Peers

Company (Ticker)	Rec	Rank
BCE, Inc. (BCE)	Neutral	3
Deutsche Telekom AG (DTEGY)	Neutral	4
Swisscom AG (SCMWY)	Neutral	3
Shenandoah Telecommunications Co (SHEN)	Neutral	4
Telecom Italia S.P.A. (TIIAI)	Neutral	3
Telstra Corp. (TLSYY)	Neutral	3
VEON Ltd. (VEON)	Neutral	3
TELUS Corporation (TU)	Underperform	4

Industry Comparison Industry: Diversified Communication Services				Industry Peers		
	TEF	X Industry	S&P 500	BCE	DTEGY	TU
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Underperform
Zacks Rank (Short Term)	3	-	-	3	4	4
VGM Score	B	-	-	C	B	D
Market Cap	25.18 B	7.42 B	20.61 B	35.86 B	68.18 B	19.43 B
# of Analysts	3	3	14	8	2	7
Dividend Yield	6.80%	0.27%	2.11%	6.28%	3.14%	2.72%
Value Score	A	-	-	C	A	C
Cash/Price	0.45	0.08	0.06	0.00	0.16	0.02
EV/EBITDA	11.04	7.54	11.87	7.54	5.57	7.73
PEG Ratio	1.38	2.21	2.47	3.56	2.18	4.32
Price/Book (P/B)	0.88	1.61	2.67	2.73	1.36	2.41
Price/Cash Flow (P/CF)	5.91	5.61	10.66	6.30	3.18	6.06
P/E (F1)	8.30	17.45	19.01	16.38	15.15	18.38
Price/Sales (P/S)	0.46	1.26	2.10	1.98	0.76	1.75
Earnings Yield	11.75%	5.68%	5.05%	6.10%	6.56%	5.44%
Debt/Equity	1.92	1.10	0.72	1.29	1.59	1.61
Cash Flow (\$/share)	0.77	1.94	7.01	6.42	4.56	2.70
Growth Score	C	-	-	C	B	D
Hist. EPS Growth (3-5 yrs)	2.10%	1.77%	10.88%	-0.15%	NA	1.94%
Proj. EPS Growth (F1/F0)	-22.37%	-2.93%	-7.32%	-8.33%	-17.47%	-20.84%
Curr. Cash Flow Growth	-28.39%	-4.22%	5.92%	5.00%	-6.88%	7.95%
Hist. Cash Flow Growth (3-5 yrs)	-4.61%	-0.03%	8.55%	2.41%	3.48%	2.83%
Current Ratio	0.81	0.81	1.23	0.56	0.70	0.78
Debt/Capital	65.78%	53.43%	43.84%	51.15%	61.36%	61.66%
Net Margin	2.41%	7.10%	11.08%	12.84%	3.47%	11.92%
Return on Equity	13.93%	11.17%	16.44%	18.89%	10.76%	16.37%
Sales/Assets	0.39	0.47	0.54	0.40	0.49	0.41
Proj. Sales Growth (F1/F0)	-7.74%	-0.12%	-1.42%	-6.02%	NA	-1.61%
Momentum Score	F	-	-	C	F	C
Daily Price Chg	-2.15%	0.00%	-2.39%	-1.96%	0.14%	-1.98%
1 Week Price Chg	-3.29%	-1.29%	-1.74%	-3.74%	0.37%	-1.29%
4 Week Price Chg	1.11%	2.82%	17.07%	0.07%	16.07%	3.09%
12 Week Price Chg	-33.14%	-15.39%	-18.53%	-16.29%	-10.76%	-19.60%
52 Week Price Chg	-44.05%	-13.85%	-9.82%	-8.90%	-13.57%	-10.85%
20 Day Average Volume	1,189,452	189,244	2,641,413	1,395,301	256,649	1,244,818
(F1) EPS Est 1 week change	-8.11%	0.00%	0.00%	0.00%	-2.07%	0.00%
(F1) EPS Est 4 week change	-8.11%	-6.88%	-6.62%	-10.32%	-25.00%	-8.73%
(F1) EPS Est 12 week change	-25.44%	-21.76%	-13.28%	-15.16%	-21.90%	-28.67%
(Q1) EPS Est Mthly Chg	NA%	-4.58%	-11.97%	-7.19%	NA	-4.58%

---

## Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

### Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

### Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

---

### Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	A
Growth Score	C
Momentum Score	F
VGM Score	B

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

---

### Disclosures

**This report contains independent commentary to be used for informational purposes only. The analysts contributing to this report do not hold any shares of this stock. The analysts contributing to this report do not serve on the board of the company that issued this stock. The EPS and revenue forecasts are the Zacks Consensus estimates, unless indicated otherwise on the reports first page.** Additionally, the analysts contributing to this report certify that the views expressed herein accurately reflect the analysts personal views as to the subject securities and issuers. ZIR certifies that no part of the analysts compensation was, is, or will be, directly or indirectly, related to the specific recommendation or views expressed by the analyst in the report.

Additional information on the securities mentioned in this report is available upon request. This report is based on data obtained from sources we believe to be reliable, but is not guaranteed as to accuracy and does not purport to be complete. Any opinions expressed herein are subject to change.

ZIR is not an investment advisor and the report should not be construed as advice designed to meet the particular investment needs of any investor. Prior to making any investment decision, you are advised to consult with your broker, investment advisor, or other appropriate tax or financial professional to determine the suitability of any investment. This report and others like it are published regularly and not in response to episodic market activity or events affecting the securities industry.

This report is not to be construed as an offer or the solicitation of an offer to buy or sell the securities herein mentioned. ZIR or its officers, employees or customers may have a position long or short in the securities mentioned and buy or sell the securities from time to time. ZIR is not a broker-dealer. ZIR may enter into arms-length agreements with broker-dealers to provide this research to their clients. Zacks and its staff are not involved in investment banking activities for the stock issuer covered in this report.

ZIR uses the following rating system for the securities it covers. **Outperform-** ZIR expects that the subject company will outperform the broader U.S. equities markets over the next six to twelve months. **Neutral-** ZIR expects that the company will perform in line with the broader U.S. equities markets over the next six to twelve months. **Underperform-** ZIR expects the company will underperform the broader U.S. equities markets over the next six to twelve months.

No part of this report can be reprinted, republished or transmitted electronically without the prior written authorization of ZIR.