

Telefonica, S.A. (TEF)

\$7.08 (As of 01/03/20)

Price Target (6-12 Months): **\$7.75**

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:C

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 substantially accelerated the deployment of ultra-fast networks. Continued rollout of fiber and LTE are set to drive growth. Lower wireless penetration rate in Mexico is likely to benefit Telefonica where it has considerable presence. However, domestic competition remains a hurdle as unbundled local loop regulation is compelling it to make its network available to alternative providers, resulting in wireline telephony access erosion. It faces increased competition in Brazil. Although it is striving to bring down debts through sale of non-strategic assets and reduction of dividend payouts, high debt-laden balance sheet remains a concern.

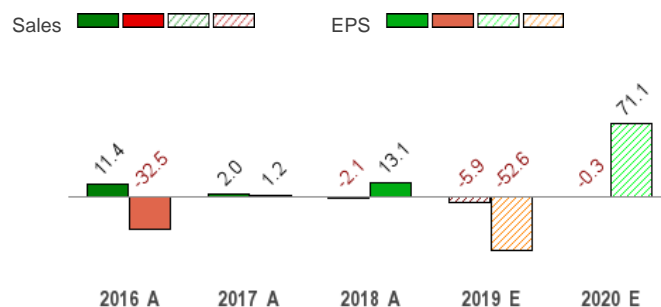
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$9.01 - \$6.50
20 Day Average Volume (sh)	1,474,106
Market Cap	\$36.8 B
YTD Price Change	1.6%
Beta	0.66
Dividend / Div Yld	\$0.33 / 4.7%
Industry	Diversified Communication Services
Zacks Industry Rank	Bottom 12% (221 out of 252)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	NA
Last Sales Surprise	NA
EPS F1 Est- 4 week change	-1.5%
Expected Report Date	02/20/2020
Earnings ESP	0.0%
P/E TTM	8.7
P/E F1	9.3
PEG F1	1.6
P/S TTM	0.7

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020					53,940 E
2019	13,604 A	13,645 A	13,233 A		54,100 E
2018	14,977 A	14,489 A	13,601 A	14,748 A	57,507 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020					\$0.77 E
2019	\$0.20 A	\$0.21 A	\$0.14 A		\$0.45 E
2018	\$0.21 A	\$0.24 A	\$0.24 A	\$0.26 A	\$0.95 A

*Quarterly figures may not add up to annual.

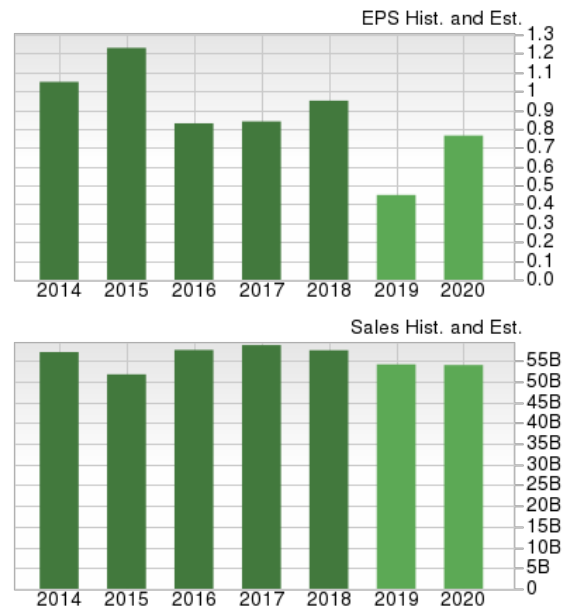
The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 01/03/2020. The reports text is as of 01/06/2020.

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** (27% of total revenues in third-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** (15.7%): This segment offers fixed and mobile telephony services, broadband Internet, pay TV, data and value-added services in Germany.
- **Telefonica U.K.** (14.9%): This segment offers fixed and mobile telephony services, broadband Internet, pay TV, data and value-added services in the U.K.
- **Telefonica Brasil** (21.1%): 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** (12%): 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 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 (\$2.20 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 has reiterated its financial outlook for full-year 2019. It expects revenues to grow around 2% year over year, while OIBDA margin is anticipated to expand nearly 2%.

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. Notably, its GAAP earnings per share have declined at a CAGR of 16.2% from 2010 to 2018, which is worrisome.
- ▼ Telefonica has a debt-laden balance sheet. As of Sep 30, 2019, the company had cash and cash equivalents of €8,778 million with non-current financial liabilities of €47,611 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. The company also looks relatively more leveraged than the industry. Markedly, its debt/equity ratio is currently at 2.11, significantly higher than 0.88 recorded by the industry.

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 Q3, Revenues Increase Y/Y

Telefonica reported lackluster third-quarter 2019 financial results, due to the depreciation of Brazilian Real and Argentine Peso coupled with the provision for restructuring costs.

Net Loss

For the September quarter, the Spanish telecom giant's net loss was €443 million or loss of €0.10 per share (\$492.5 million or 11 cents per share) against net income of €1,139 million or €0.21 per share in the year-ago quarter. The decline was primarily due to the provision for restructuring costs and depreciation of Brazilian Real and Argentine Peso against Euro. On an adjusted basis, net income came in at 14 cents per share.

Revenues

Quarterly total revenues increased 1.7% year over year to €11,902 million (\$13,231.1 million), driven by higher revenues from broadband connectivity services. Organic revenues were up 3.4%, backed by strong handset sales and sustained service revenue growth.

Results by Business Units

Telefonica Espana: Revenues in Spain increased 0.9% year over year to €3,218 million (\$3,577.4 million), driven by service revenue growth.

Telefonica Deutschland: Revenues increased 1.9% to €1,865 million (\$2,073.3 million), backed by strong consumer demand for handsets. OIBDA margin was 32% compared with 25.7% in the year-ago quarter, mainly due to top-line growth and market investments.

Telefonica UK: Revenues were up 3% year over year to €1,773 million (\$1,971 million). This was driven by higher value smartphone sales, increased subscriptions as well as growth in MVNO and Smart Metering Implementation Programme revenues. OIBDA margin was 30.6% compared with 26.9% in the year-ago quarter led by solid revenue trends and efficient cost management.

Telefonica Brasil: Revenues in Brazil increased 6.9% to €2,507 million (\$2,787 million) primarily driven by higher mobile service revenues. OIBDA margin declined to 42.7% from 45.9% owing to regulatory impacts.

Telefonica Hispam Sur: Revenues from this segment were up 8.7% to €1,430 million (\$1,589.7 million) mainly driven by solid broadband revenues and savings from digitization. OIBDA margin declined to 23.1% from 23.7% due to the adoption of IFRS 16.

Telefonica Hispam Norte: Revenues from this segment declined 14% year over year to €895 million (\$994.9 million), affected by intense competition and spectrum commitments in Mexico. OIBDA margin increased to 30.7% from 30.2%.

Other Details

Overall OIBDA (operating income before depreciation and amortization) came in at €2,748 million, down 31.9% year over year, mainly affected by the depreciation of Brazilian Real and Argentine Peso against Euro with the adoption of IFRS 16 accounting standard. OIBDA margin declined to 23.1% compared with 34.5% in the year-ago quarter, owing to the provision for restructuring costs. Operating income was down 91.2% to €169 million. The drastic decline was mainly due to the impact of IFRS 16 accounting standard.

Cash Flow & Liquidity

During the first nine months of 2019, Telefonica generated €11,053 million of net cash from operating activities compared with €9,210 million in the year-ago period. As of Sep 30, 2019, the company had cash and cash equivalents of €8,778 million (\$9,582.3 million), with non-current financial liabilities of €47,611 million (\$51,973.4 million).

2019 Guidance Reiterated

Telefonica has reiterated financial outlook for full-year 2019. The company expects revenues to grow around 2% year over year, while OIBDA is anticipated to expand nearly 2%.

Conversion rate used:

€1 = \$1.111672 (period average from Jul 1, 2019 to Sep 30, 2019)

€1 = \$1.091626 (as of Sep 30, 2019)

Quarter Ending 09/2019

Report Date	Nov 05, 2019
Sales Surprise	NA
EPS Surprise	NA
Quarterly EPS	0.14
Annual EPS (TTM)	0.81

Recent News

On Dec 6, 2019, it came to the fore that Telefonica is considering to augment its 5G network infrastructure in Spain by reinforcing its long-term partnership with Huawei. In addition, the company will adopt a multi-vendor strategy by collaborating with another unnamed service provider in order to establish its 5G infrastructure in 2020. Nokia and Ericsson are potential contenders to join the fray and team up with Telefonica in Spain.

On Nov 27, 2019, Telefonica announced that it will be restructuring its Latin American business, while remaining focused on 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 (\$2.20 billion) a year by 2022.

On Nov 21, 2019, Telefonica announced that it has collaborated with Mexican counterpart of U.S. telecom carrier — AT&T — in a bid to compete with Mexican telecom giant, America Movil. Per the deal, Telefonica will utilize AT&T's wireless 'last-mile' equipment to deliver service through towers, antennas and fiber-optic cables. Financial terms of the agreement were not disclosed. With intense competition in the Mexican wireless industry, the collaboration is likely reduce Telefonica's debt of €500 million and lead to total savings of €230 million after a three-year transition period.

Valuation

Telefonica shares are down 20.3% over the trailing 12-month period. Stocks in the Zacks sub-industry are down 28.5% over the past year, but stocks in the Zacks Utilities sector are up 3.1% in the same time frame.

The S&P 500 Index is up 25.7% in the past year.

The stock is currently trading at 1.31X trailing 12-month book value, which compares to 3.11X for the Zacks sub-industry, 3.93X for the Zacks sector and 4.41X for the S&P 500 Index.

Over the past five years, the stock has traded as high as 2.06X and as low as 1.14X, with a 5-year median of 1.62X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$7.75 price target reflects 5.92X 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	1.31	3.11	3.93	4.41
	5-Year High	2.06	4.8	3.96	4.45
	5-Year Low	1.14	1.81	2.01	2.85
	5-Year Median	1.62	2.42	2.55	3.6
P/E F12M	Current	9.26	11.04	13.43	18.71
	5-Year High	20.46	17.71	15.33	19.34
	5-Year Low	7.26	10.67	12.61	15.17
	5-Year Median	11.19	15.21	13.68	17.44
P/S F12M	Current	0.68	1.29	2.89	3.47
	5-Year High	1.4	4.11	3.26	3.47
	5-Year Low	0.62	1.13	1.7	2.54
	5-Year Median	0.86	1.33	1.95	3

As of 01/03/2020

Industry Analysis Zacks Industry Rank: Bottom 12% (221 out of 252)



Top Peers

BCE, Inc. (BCE)	Neutral
Cincinnati Bell Inc (CBB)	Neutral
Deutsche Telekom AG (DTEGY)	Neutral
Swisscom AG (SCMWY)	Neutral
Shenandoah Telecommunications Co (SHEN)	Neutral
Telstra Corp. (TLSYY)	Neutral
TELUS Corporation (TU)	Neutral
VEON Ltd. (VEON)	Neutral

Industry Comparison Industry: Diversified Communication Services				Industry Peers		
	TEF Neutral	X Industry	S&P 500	BCE Neutral	CBB Neutral	TU Neutral
VGM Score	C	-	-	C	C	C
Market Cap	36.76 B	10.09 B	23.66 B	41.55 B	523.37 M	23.38 B
# of Analysts	1	1	13	8	1	8
Dividend Yield	4.66%	0.00%	1.79%	5.19%	0.00%	4.53%
Value Score	A	-	-	C	C	B
Cash/Price	0.35	0.09	0.04	0.02	0.01	0.01
EV/EBITDA	8.49	7.07	13.88	8.78	7.99	8.97
PEG Ratio	1.55	1.79	1.99	3.94	NA	2.48
Price/Book (P/B)	1.31	2.09	3.36	3.18	NA	2.83
Price/Cash Flow (P/CF)	6.58	6.25	13.62	7.47	2.60	7.66
P/E (F1)	9.29	15.95	18.74	16.14	NA	15.90
Price/Sales (P/S)	0.67	1.05	2.67	2.31	0.34	2.11
Earnings Yield	10.73%	6.24%	5.32%	6.20%	-10.21%	6.28%
Debt/Equity	2.11	0.88	0.72	1.30	-7.53	1.49
Cash Flow (\$/share)	1.08	2.79	6.94	6.15	3.99	5.05
Growth Score	C	-	-	C	B	C
Hist. EPS Growth (3-5 yrs)	2.14%	-0.55%	10.56%	-0.55%	NA	1.45%
Proj. EPS Growth (F1/F0)	70.00%	9.65%	7.41%	6.75%	17.19%	11.57%
Curr. Cash Flow Growth	20.62%	-4.22%	14.83%	4.14%	0.30%	5.20%
Hist. Cash Flow Growth (3-5 yrs)	-2.35%	-1.64%	9.00%	0.57%	2.16%	0.13%
Current Ratio	0.88	0.86	1.23	0.60	0.75	0.80
Debt/Capital	67.84%	50.85%	42.92%	51.35%	NA	59.79%
Net Margin	4.03%	7.54%	11.08%	12.61%	-4.92%	11.91%
Return on Equity	14.38%	12.43%	17.10%	18.75%	NA	16.54%
Sales/Assets	0.40	0.49	0.55	0.40	0.58	0.42
Proj. Sales Growth (F1/F0)	-0.30%	0.89%	4.20%	1.99%	0.28%	6.30%
Momentum Score	F	-	-	B	F	D
Daily Price Chg	-0.14%	0.00%	-0.61%	0.11%	-0.10%	-0.28%
1 Week Price Chg	-1.38%	0.00%	0.13%	0.17%	36.27%	0.65%
4 Week Price Chg	-5.47%	0.00%	2.60%	-5.39%	51.53%	0.34%
12 Week Price Chg	-6.60%	-1.42%	8.87%	-6.05%	149.52%	7.83%
52 Week Price Chg	-17.67%	4.90%	29.34%	14.81%	25.97%	16.25%
20 Day Average Volume	1,474,106	44,482	1,603,615	965,293	1,024,021	351,213
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-1.50%	0.00%	0.00%	-0.04%	-54.18%	-0.66%
(F1) EPS Est 12 week change	-2.75%	-0.44%	-0.57%	0.75%	-63.71%	2.74%
(Q1) EPS Est Mthly Chg	NA%	0.00%	0.00%	0.00%	-77.14%	0.00%

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	C

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.

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