

Telefonica, S.A. (TEF)

\$4.77 (As of 07/16/20)

Price Target (6-12 Months): **\$5.00**

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 well poised to capitalize on opportunities in the digital world through several growth initiatives to enhance long-term prospects. It experiences increased traction in the smartphone market. The consistent rollout of fiber and LTE is set to drive growth. Acquisitions are considered to be the preferred mode for business expansion. With a major upheaval in eight Latin American markets, the company aims to 'reinvent' itself amid a challenging macroeconomic environment. However, domestic competition is a headwind as unbundled local loop regulation is compelling the company to make its network available to alternative providers. It is exposed to intense competition in Brazil. The existence of critical suppliers in the supply chain poses risks to Telefonica's business operations. High debt-laden balance sheet is another concern.

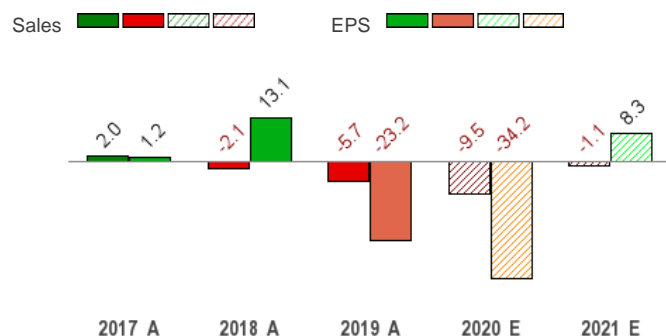
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$8.25 - \$3.75
20 Day Average Volume (sh)	915,023
Market Cap	\$24.8 B
YTD Price Change	-31.6%
Beta	0.83
Dividend / Div Yld	\$0.30 / 6.3%
Industry	Diversified Communication Services
Zacks Industry Rank	Top 27% (67 out of 251)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	NA
Last Sales Surprise	NA
EPS F1 Est- 4 week change	-2.1%
Expected Report Date	07/23/2020
Earnings ESP	0.0%
P/E TTM	7.1
P/E F1	9.9
PEG F1	1.7
P/S TTM	0.5

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021					48,553 E
2020	12,537 A				49,080 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					\$0.52 E
2020	\$0.12 A				\$0.48 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 07/16/2020. The reports text is as of 07/17/2020.

Overview

Headquartered in Madrid, Spain, Telefonica, S.A. provides mobile and fixed communication services in Europe and Latin America.

In recent years, Telefonica has invested heavily in the deployment and transformation of its network to provide excellent connectivity in all of its dimensions, capacity, speed, coverage and security. The business operations of the company are classified according to the following geographic regions.

Telefonica Espana (27.3% of aggregate revenues in first-quarter 2020): The segment oversees the fixed and mobile telephone, broadband Internet, pay TV and value added services and data businesses in Spain (Espana).

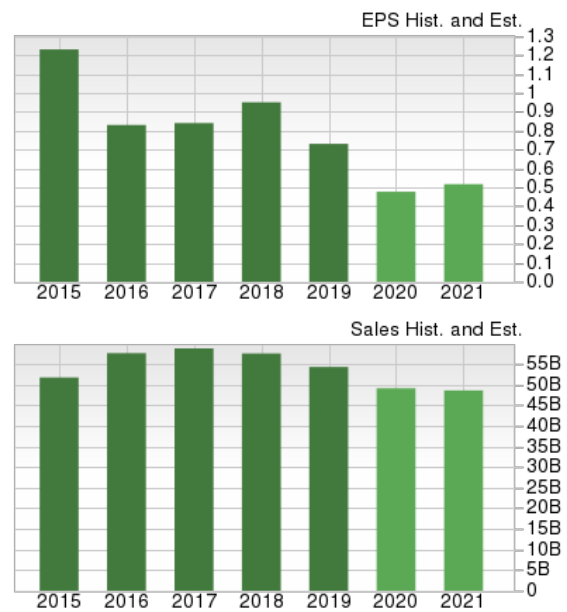
Telefonica Deutschland (16.4%): This segment offers fixed and mobile telephony services, broadband Internet, pay TV, data and value-added services in Germany.

Telefonica UK (15.4%): This segment offers fixed and mobile telephony services, broadband Internet, pay TV, data and value-added services in the U.K.

Telefonica Brasil (19.6%): This segment offers fixed and mobile telephony services, broadband Internet, pay TV, data and value-added services in Brazil.

Telefonica Hispam (19.5%): This segment offers fixed and mobile telephony services, broadband Internet, pay TV, data and value-added services in Argentina, Chile, Peru and Uruguay.

Telefonica Infra (Telxius) (1.8%): Starting first-quarter 2020, Telefonica Infra is a segment of the Telefonica Group acting as a portfolio manager owning stakes in infrastructure alongside financial investors. Telefonica Infra's consolidation perimeter includes Telxius as its first asset.



Reasons To Buy:

- ▲ In recent years, Telefonica has invested heavily in the deployment and transformation of its network to provide excellent connectivity in all of its dimensions, capacity, speed, coverage and security. 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 acquired 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. 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 has restructured 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 has created 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 capitalizing on the opportunities in the digital world through several growth strategies. Also, the company has accelerated the deployment of ultrafast networks. Notably, it continues to witness increased traction in the smartphone arena. The continued rollout of fiber and LTE is set to drive considerable growth. Telefonica is augmenting its 5G network infrastructure in Spain by reinforcing long-term partnership with Huawei. The company has adopted 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.

The 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 Mar 31, 2020, the company had €9,646 million in cash and equivalents with €53,350 million of long-term debt compared with the respective tallies of \$10,265 million and \$54,784 million at the end of the prior quarter. Although the company is striving to bring down its debt through modified financial strategies, accumulating debt may pose problem for its credit ratings going forward. Telefonica currently has a debt-to-capital ratio of 0.73 compared with 0.67 of the sub-industry. The times interest earned has decreased over the past few quarters to 1.8 at present relative to 1.6 for the sub-industry. This shows that the company is less likely to clear its debt. However, Telefonica has a dividend payout rate of 50.4% compared with 60.6% of the sub-industry. The rate has also improved over the past few quarters, indicating that the company is sharing more of its earnings with stockholders. It remains to be seen if Telefonica can turn the tables in the coming days despite disruptions caused by the COVID-19 pandemic.

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

Last Earnings Report

Telefonica's Q1 Earnings and Revenues Decrease Y/Y

Telefonica reported unimpressive first-quarter 2020 results, with the top and the bottom line declining on a year-over-year basis.

Net Income

In the March quarter, the Spanish telecom giant's net income was €406 million or €0.06 per share (\$447.8 million or 7 cents per share) compared with €926 million or €0.16 per share in the year-ago quarter. On an adjusted basis, net income per share came in at €0.11 (12 cents) compared with €0.16 in the prior-year quarter.

Revenues

Quarterly aggregate revenues declined 5.1% year over year to €11,366 million (\$12,535.3 million) mainly due to currency effect and changes in the perimeter. In organic terms, revenues decreased 1.3% year over year due to lower service revenues while handset sales remained broadly stable.

Results by Business Units

Telefonica Espana: Revenues in Spain slipped 1.6% year over year on a reported basis to €3,078 million (\$3,394.6 million), as the COVID-19 crisis had an initial impact limited to the sale of handsets and convergent bundles from bars and restaurants. The OIBDA margin was 39.8% compared with 43.4% in the year-ago quarter, mainly as a result of lower revenues.

Telefonica Deutschland: Revenues grew 3.8% to €1,846 million (\$2,035.9 million). The growth was backed by ARPU-accretive effects on mobile service revenues from the O2 Free portfolio. Also, the handset business remained strong and fixed revenues showed improvements. The OIBDA margin was 28.8% compared with 29.4% in the year-ago quarter.

Telefonica UK: Revenues increased 2.9% year over year to €1,739 million (\$1,917.9 million). This was driven by higher value handset revenues and consistent growth in SMIP and MVNO revenues. The OIBDA margin was 29.7% compared with 29.8% in the year-ago quarter, slightly offset by initial COVID-19 related costs.

Telefonica Brasil: Revenues in Brazil declined 13.6% to €2,215 million (\$2,442.9 million) primarily due to a reduction in DTH revenues, fixed voice and, to a lesser extent, handset sales. On the contrary, it's worth noting the return to growth in prepaid and the strong growth in both FTTH revenues and IPTV. The OIBDA margin increased to 42.9% from 40.9% owing to growth in revenues associated with new technologies and the progressive achievement of efficiencies that allowed operating expenses to be reduced by 2.1%.

Telefonica Hispam: Revenues in this segment declined 8.4% to €2,204 million (\$2,430.7 million) due to lower handset sales and service revenues primarily in mobile along with a decrease in market prices in Chile and Peru. These effects are partially offset by strong growth in FTTH/cable revenues. The OIBDA margin declined to 22.8% from 26.5% year over year.

Telefonica Infra (Telxius): Revenues in this segment fell 5.7% year over year to €207 million (\$228.3 million). Starting first-quarter 2020, Telefonica Infra is a segment of the Telefonica Group acting as a portfolio manager owing stakes in infrastructure alongside financial investors. Telefonica Infra's consolidation perimeter includes Telxius as its first asset. The OIBDA margin improved to 65.4% from 58.8%.

Other Details

Overall, OIBDA (operating income before depreciation and amortization) came in at €3,760 million, down 11.8% year over year. This was mainly due to €189 million of capital gains from the sale of assets recorded in first-quarter 2019 as well as currencies evolution and changes in the perimeter. The OIBDA margin was 33.1% compared with 35.6% in the year-ago quarter. Operating income was down 33.9% to €1,091 million.

Cash Flow & Liquidity

In the first quarter of 2020, Telefonica generated €2,259 million of net cash from operating activities compared with €3,659 million in the year-ago quarter. As of Mar 31, 2020, the company had €5,021 million (\$5,522.9 million) in cash and equivalents with €43,588 million (\$47,944.8 million) of non-current financial liabilities.

Conversion rate used:

€1 = \$1.102875 (period average from Jan 1, 2020 to Mar 31, 2020)

€1 = \$1.099954 (as of Mar 31, 2020)

Quarter Ending 03/2020

Report Date	May 07, 2020
Sales Surprise	NA
EPS Surprise	NA
Quarterly EPS	0.12
Annual EPS (TTM)	0.67

Recent News

On Jul 7, 2020, Telefonica announced that it has joined forces with Nozomi Networks with significant investment in a bid to reinforce cybersecurity solutions across industrial environments. Markedly, the investment was made through Telefonica's corporate venture capital arm — Telefonica Innovation Ventures. With the investment, Telefonica will be able to strengthen its security services and enhance operational reliability by providing best-in-class protection to critical assets amid evolving cyber threats. However, financial terms of the deal have been kept under wraps.

On May 7, per Reuters, Telefonica Brasil announced that its British telecommunications subsidiary — O2 — will be merging with yet another UK-based telecom giant — Virgin Media. Notably, Virgin Media is a subsidiary of Liberty Global, a multinational telecommunications company. The two companies have agreed to merge their British businesses at a whopping valuation of \$38 billion. 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.

On Mar 10, 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 41.9% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Utilities sector are down 22.2% and 12.2% over the past year, respectively.

The S&P 500 Index is up 8.4% in the past year.

The stock is currently trading at 1.05X trailing 12-month book value, which compares to 2.91X for the Zacks sub-industry, 3.61X for the Zacks sector and 4.42X 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 1.57X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$5.00 price target reflects 4.76X 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	1.05	2.91	3.61	4.42
	5-Year High	2.06	4.66	4.17	4.56
	5-Year Low	0.75	1.75	2.01	2.83
	5-Year Median	1.57	2.4	2.62	3.71
P/E F12M	Current	9.84	11.9	12.38	22.89
	5-Year High	20.46	17.46	15.32	22.89
	5-Year Low	6.22	10.04	11.4	15.25
	5-Year Median	10.63	14.82	13.78	17.52
P/S F12M	Current	0.52	1.15	2.65	3.58
	5-Year High	1.39	3.93	3.29	3.58
	5-Year Low	0.41	1.05	1.75	2.53
	5-Year Median	0.81	1.29	2.06	3.02

As of 07/16/2020

Industry Analysis Zacks Industry Rank: Top 27% (67 out of 251)



Top Peers

Company (Ticker)	Rec	Rank
Swisscom AG (SCMWY)	Outperform	2
Telstra Corp. (TLSYY)	Outperform	2
BCE, Inc. (BCE)	Neutral	3
Deutsche Telekom AG (DTEGY)	Neutral	2
Shenandoah Telecommunications Co (SHEN)	Neutral	2
Telecom Italia S.P.A. (TIAY)	Neutral	3
TELUS Corporation (TU)	Neutral	3
VEON Ltd. (VEON)	Neutral	2

Industry Comparison Industry: Diversified Communication Services				Industry Peers		
	TEF	X Industry	S&P 500	BCE	DTEGY	TU
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	3	2	3
VGM Score	B	-	-	C	A	B
Market Cap	24.77 B	9.31 B	22.43 B	38.11 B	83.17 B	22.49 B
# of Analysts	3	3	14	7	2	7
Dividend Yield	6.33%	2.00%	1.82%	5.81%	3.71%	4.81%
Value Score	A	-	-	B	A	B
Cash/Price	0.40	0.09	0.07	0.05	0.11	0.04
EV/EBITDA	11.09	6.48	13.00	7.78	4.99	8.37
PEG Ratio	1.64	3.42	2.97	4.11	2.26	3.42
Price/Book (P/B)	1.05	2.22	3.13	2.63	1.64	2.30
Price/Cash Flow (P/CF)	6.19	5.61	12.13	6.56	3.34	6.52
P/E (F1)	9.83	18.69	21.97	18.69	15.74	19.22
Price/Sales (P/S)	0.47	1.21	2.38	2.12	0.92	2.00
Earnings Yield	10.06%	5.34%	4.35%	5.34%	6.35%	5.23%
Debt/Equity	2.25	1.29	0.75	1.31	1.58	1.37
Cash Flow (\$/share)	0.77	2.32	6.94	6.42	5.23	2.70
Growth Score	C	-	-	C	C	C
Hist. EPS Growth (3-5 yrs)	0.99%	1.61%	10.85%	0.21%	10.45%	2.23%
Proj. EPS Growth (F1/F0)	-34.70%	0.54%	-9.37%	-14.61%	2.78%	-16.75%
Curr. Cash Flow Growth	-28.39%	0.87%	5.51%	5.00%	14.82%	7.95%
Hist. Cash Flow Growth (3-5 yrs)	-4.61%	0.12%	8.55%	2.41%	7.59%	2.83%
Current Ratio	0.79	0.88	1.30	0.88	0.74	0.90
Debt/Capital	69.25%	55.71%	44.33%	52.13%	61.19%	57.83%
Net Margin	1.32%	7.57%	10.59%	12.63%	4.80%	11.25%
Return on Equity	13.32%	11.51%	15.74%	18.24%	10.40%	14.94%
Sales/Assets	0.40	0.44	0.54	0.39	0.47	0.39
Proj. Sales Growth (F1/F0)	-9.47%	-0.36%	-2.44%	-7.80%	27.47%	-0.88%
Momentum Score	F	-	-	D	C	C
Daily Price Chg	1.06%	0.00%	-0.06%	1.03%	0.68%	0.98%
1 Week Price Chg	-3.97%	0.00%	-0.41%	-2.43%	0.09%	-0.12%
4 Week Price Chg	-2.85%	0.00%	1.63%	-0.64%	2.75%	2.21%
12 Week Price Chg	9.91%	9.48%	15.55%	5.09%	30.65%	11.11%
52 Week Price Chg	-41.97%	-8.63%	-4.26%	-8.63%	5.10%	-5.20%
20 Day Average Volume	915,023	53,344	2,236,294	1,173,599	188,832	1,249,562
(F1) EPS Est 1 week change	-2.05%	0.00%	0.00%	-0.69%	0.00%	0.16%
(F1) EPS Est 4 week change	-2.05%	0.00%	0.01%	-1.44%	0.00%	0.31%
(F1) EPS Est 12 week change	-22.70%	-2.00%	-5.24%	-6.85%	15.03%	5.17%
(Q1) EPS Est Mthly Chg	NA%	0.00%	0.00%	3.18%	NA	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	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.

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