

We invest in winners. That means we invest in strong companies that create value for their shareholders with sustainable business models, solid balance sheets and high margins. We keep the risks low and invest when our position is fuelled by a positive event. We refer to that as the combination of value and event.

Telefónica S.A. Bond 2007 (14)

Telefónica S.A. of Spain is one of the world's largest telecommunications companies with over 300 million customers and around 270,000 employees. In the past 2011 financial year the group generated revenues of EUR 63 billion and an operating profit (EBITDA) of approximately EUR 20 billion. This reflects the good international positioning of the company, which was founded in 1924 and has been highly expansive up to the present day. With the Movistar brand Telefónica is market leader in Latin America and in its home market of Spain. In the rest of Europe Telefónica is represented with O2 after acquiring the British phone company of that name in 2005 for the equivalent of EUR 26 billion in cash.

The operating profit before depreciation and amortization veils over the difficulties of a highly regulated industry, where companies have to invest huge amounts to be able to keep up with the technology leaps and win the battle for subscriber loyalty. The industry is characterized by dogged but intensive predatory and price competition. Despite the growth in data traffic, this has led to a continuous decline in revenues from telecom services. For this reason we are avoiding stocks of companies in this sector.

On the other hand, a bond of Telefónica caught our interest. It was issued in a nominal volume of EUR 1.5 billion and has a short

remaining life to maturity of less than two years. The annual coupon is 4.674%. Despite the good rating from Standard & Poor's (BBB+) the bond was meanwhile trading at around 101% and thus roughly 300 basis points (asset swap spread) below its fair value.

This was probably because of Spain's debt crisis. But Spain actually only accounts for 27% of Telefónica's revenues and 25% of its EBITDA. The group derives about half of its income in Latin America, above all in Brazil.

A main reason for our investment at a price of 101% was the company's debt bearing capacity, which is comfortably secured by its financial and earnings situation. Net debt is admittedly high at EUR 56 billion but is reasonable in relative terms at about three times operating cash flow. After deducting capex, cash flow covers the interest load four times. The amounts due until redemption of our bond can be serviced largely from existing liquidity and the available credit lines.

The ability of this global player to tap the capital market at any time, its assets and operating earning power represent a sufficient margin of safety for us. Meanwhile, the bond has recouped its undervaluation almost completely.

We continue to see it as a profitable substitute for cash that helps stabilize our fund.

Sincerely yours



J. Henrik Muhle



Dr. Uwe Rathausky